Internal Revenue
bulletin

Bulletin No. 2003–7
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2003–18, page 467.

Section 355. This ruling discusses whether the acquisition by D, a brand X automobile dealer, of a brand Y automobile dealership constitutes an expansion of the brand X business or an acquisition of a new or different business under section 1.355–3(b)(3)(ii) of the regulations. Rev. Rul. 57–190 obsoleted.

Rev. Rul. 2003–19, page 468.

Insurance demutualization. This ruling provides guidance as to the tax consequences that occur when, as described in the facts set forth in this ruling, a mutual insurance company converts to a stock insurance company.

Rev. Rul. 2003–20, page 465.

New markets tax credit. This ruling holds that, for purposes of determining the new markets tax credit under the facts of the ruling, the amount of the qualified equity investment made by a limited liability company (LLC) classified as a partnership includes cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity.

T.D. 9032, page 471

Final regulations provide guidance with respect to an election under section 645 of the Code to have certain revocable trusts be treated and taxed as part of an estate. These regulations also provide reporting rules for a trust that is treated as owned by the grantor, or another person under provisions of the Code for the taxable year ending with the death of the grantor or other person. Notice 2001–26 and Rev. Proc. 98–13 obsoleted.

T.D. 9033, page 483.

REG–124069–02, page 488.

Final, temporary, and proposed regulations under section 6038 of the Code provide that a United States partner must follow the filing requirements that are specified in the instructions for Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, when the United States partner must file Form 8865 and the foreign partnership completes and files Form 1065, *U.S. Return of Partnership Income*, or Form 1065-B, *U.S. Return for Electing Large Partnerships*. This amendment would facilitate revisions to the filing requirements such as electronic filing for Form 8865. A public hearing on the proposed regulations is scheduled for March 12, 2003.

T.D. 9034, page 453.

Final regulations under section 25A of the Code relate to the education tax credit for the payment of certain postsecondary educational expenses.

EXEMPT ORGANIZATIONS

Announcement 2003–10, page 490.

A list is provided of organizations now classified as private foundations.

(Continued on the next page)

Findings Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

REG–126016–01, page 486.
Proposed regulations under sections 6662 and 6664 of the Code limit the defenses available to the imposition of the accuracy-related penalty when taxpayers fail to disclose reportable transactions or that they have taken a position based upon a regulation being invalid. The regulations also clarify existing regulations with respect to the facts and circumstances that the IRS will consider in determining whether a taxpayer acted with reasonable cause and in good faith in relying on an opinion or advice.

Announcement 2003–9, page 490.
This document contains corrections to proposed regulations (REG–150313–01, 2002–44 I.R.B. 777) under sections 302, 304, and other sections of the Code providing guidance regarding the treatment of the basis of redeemed stock when a distribution in redemption of such stock is treated as a dividend.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 25A.—Hope and Lifetime Learning Credits

26 CFR 1.25A–1: Calculation of education tax credit and general eligibility requirements.

T.D. 9034

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Education Tax Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the Hope Scholarship Credit and the Lifetime Learning Credit under section 25A of the Internal Revenue Code. The final regulations reflect changes made to the law by the Taxpayer Relief Act of 1997. These regulations provide guidance to individuals who may claim the Hope Scholarship Credit or the Lifetime Learning Credit for the payment of certain postsecondary educational expenses.

DATES: *Effective Date:* These regulations are effective December 26, 2002.

Applicability Dates: For dates of applicability, see § 1.25A–3(f) and § 1.25A –4(d).

FOR FURTHER INFORMATION CONTACT: Marilyn E. Brookens, (202) 622–4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–1630. Responses to this collection of information are mandatory.

The collection of information is in § 1.25A–1(d) and (f). Taxpayers must elect to claim an education credit by attaching Form 8863, "*Education Credits (Hope and Lifetime Learning Credits),*" to a federal income tax return for the taxable year in which a credit is claimed. This collection of information is required in order for a taxpayer to elect to claim an education credit. This information will be used to carry out the internal revenue laws. The likely respondents are individuals.

The reporting burden contained in § 1.25A–1(d) and (f) is reflected in the burden of Form 8863, "*Education Credits (Hope and Lifetime Learning Credits),*" and Form 1040, "*U.S. Individual Income Tax Return.*"

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) regarding the Hope Scholarship Credit and the Lifetime Learning Credit (education tax credit) under section 25A of the Internal Revenue Code. The Taxpayer Relief Act of 1997 (Public Law 105–34 (111 Stat. 788) (TRA '97)) added section 25A to provide the education tax credit. In general, the education tax credit allows taxpayers to claim a nonrefundable credit against their federal income tax for the payment of certain postsecondary educational expenses. The Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16 (115 Stat. 38)) added section 222 of the Internal Revenue Code to provide an above-the-line deduction for certain postsecondary education expenses paid in taxable years beginning after December 31, 2001, and before January 1, 2006. Section 222 is an alternative to section 25A, and taxpayers cannot claim a section 222 deduction and a section 25A education tax credit in the same year with respect to the same student.

On November 17, 1997, the IRS published Notice 97–60, 1997–2 C.B. 310, to provide general guidance on the higher education tax incentives enacted by TRA '97, including the education tax credit. A notice of proposed rulemaking (REG–106388–98, 1999–1 C.B. 756 [64 FR 794]) was published in the **Federal Register** on January 6, 1999. One request for a public hearing was received. However, the request was withdrawn, and no public hearing was held. The IRS received written and electronic comments responding to the notice of proposed rulemaking. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Explanation of Provisions and Summary of Comments

1. *Reporting Requirements Under Section 6050S for Eligible Educational Institutions*

Many commentators requested clarification of the information reporting requirements under section 6050S for eligible educational institutions (institutions) that receive payments of qualified tuition and related expenses (qualified expenses). These comments are outside the scope of section 25A, which relates solely to the education tax credit allowable to taxpayers for payments of qualified expenses. However, these comments were considered by the IRS and the Treasury Department in drafting the proposed regulations under section 6050S that were published in the **Federal Register** (REG–161424–01, 2002–21 I.R.B. 1010 [67 FR 20923]) on April 29, 2002.

2. *Calculation of Education Tax Credit and General Eligibility Requirements*

Several commentators recommended changes to the rules for calculating the amount of any allowable education tax credit. One commentator recommended that the calculation of the Hope Scholarship Credit be simplified so that the credit is allowable for the first $1,500 of qualified expenses, rather than 100 percent of the first $1,000 of qualified expenses, and 50 percent of the next $1,000 of qualified expenses as provided in section 25A(b)(1). This commentator also recommended that the calculation of the Lifetime Learning

Credit be simplified so that the credit is allowable for the first $1,000 of qualified expenses, rather than 20 percent of the first $5,000 of qualified expenses as provided in section 25A(c)(1). Another commentator recommended that, for purposes of the income limitations in section 25A(d), income realized on the conversion of a traditional Individual Retirement Account (IRA) to a Roth IRA should be excluded from the definition of modified adjusted gross income. The rules in the proposed regulations regarding calculation of the amount of the education tax credit and the definition of modified adjusted gross income derive from the statutory provisions of section 25A. Therefore, the final regulations do not adopt these recommendations.

Commentators requested clarification of the rules for claiming the education tax credit in the case of a dependent. Consistent with the legislative history to section 25A, § 1.25A–1(g) of the proposed regulations provides that if a student is a claimed dependent of a taxpayer, only that taxpayer may claim the education tax credit for the student's qualified expenses; however, if the taxpayer is eligible to, but does not claim the student as a dependent, only the student may claim the education tax credit for the student's qualified expenses. The final regulations retain this rule.

Commentators asked how the student's personal exemption deduction amount under section 151 is calculated if a parent does not claim the student as a dependent on the parent's income tax return in order that the student may claim the education tax credit on the student's income tax return. Section 151(d)(2) provides a special rule for calculating the exemption deduction amount in the case of an individual (for example, a student) for whom a dependency exemption deduction is allowable to another taxpayer (for example, a parent). Under this rule, a student's personal exemption deduction amount is zero on the student's income tax return if a parent is eligible to claim the student as a dependent even if the parent does not in fact claim a dependency exemption deduction for the student. The result is the same if the amount of the dependency exemption deduction allowable to the parent is reduced or eliminated under the phase-out rule in section 151(d)(3).

Consistent with section 25A(g)(7), the proposed regulations provide that a nonresident alien individual is not eligible to claim an education tax credit, unless the individual is treated as a resident alien of the United States by reason of an election under section 6013(g) or (h). One commentator suggested that *Examples 7* and *8* in § 1.25A–3(d)(2) of the proposed regulations should be revised to avoid any confusion about the eligibility of a nonresident alien student to claim an education tax credit. The final regulations modify these examples to avoid any implication that a nonresident alien student may claim an education tax credit, in the absence of an election under section 6013(g) or (h).

Another commentator requested clarification as to whether a nonresident alien individual who elects to be treated as a resident alien may claim an education tax credit. A limited number of income tax treaties allow certain individuals to elect to be treated as residents of the United States. Because such an election is intended to apply for all tax purposes, an individual for whom a valid election under a treaty is in effect is treated as a resident for purposes of section 25A.

3. *Definitions*

Several commentators requested clarification of the definition of *academic period.* The proposed regulations provide that academic period means a quarter, semester, trimester, or other period of study (such as a summer school session) as reasonably determined by the eligible educational institution. As stated in the preamble of the proposed regulations, this definition is intended to include institutions that use traditional academic terms and institutions that do not use academic terms, but for example use clock hours or credit hours. The IRS and the Treasury Department invited comments on the proposed definition. One commentator suggested that the final regulations provide that, in the case of institutions that use clock hours or credit hours, but do not use traditional academic terms, the term academic period may include a *payment period* as defined by the Department of Education in 34 CFR 668.4. The final regulations adopt this recommendation.

Several commentators requested clarification of the definition of *qualified tuition and related expenses.* The proposed regulations define qualified tuition and related expenses to mean tuition and fees required for the enrollment or attendance of a student for courses of instruction at an eligible educational institution. The proposed regulations provide that, in general, the test for determining whether a fee is a qualified expense is whether the fee is required to be paid to the institution as a condition of the student's enrollment or attendance at the institution. However, the proposed regulations also provide that qualified expenses do not include the costs of room and board, insurance, medical expenses, transportation, and similar personal, living, or family expenses, regardless of whether the payment of such fees is required for the student's enrollment or attendance. The final regulations retain these rules.

One commentator requested clarification as to whether an education tax credit is allowable for amounts paid in one year for an independent study course which the student has up to two years to complete. The proposed regulations provide that qualified expenses paid in one taxable year may qualify for an education tax credit in the year of the payment if the expenses relate to education furnished during an academic period beginning in the year of payment or within the first three months of the next taxable year. The final regulations retain this rule. Therefore, an education tax credit is allowable for qualified expenses paid in one taxable year for independent study during an academic period that begins in the taxable year of payment or within the first three months of the next taxable year.

One commentator requested clarification as to when amounts paid for books are qualified expenses. The proposed regulations provide that, in general, an education tax credit is not available for expenses incurred to purchase books. The final regulations continue to provide that qualified expenses include fees for books, supplies, and equipment used in a course of study only if the fees must be paid to the institution for the enrollment or attendance of the student at the institution. In this situation, the amount paid for books is a required fee.

Other commentators requested clarification as to whether a required student health service fee and a required transportation fee are qualified expenses. Consistent with the legislative history to section 25A, the final regulations continue to provide that qualified expenses do not include fees for room and board, insurance,

medical expenses, transportation, and similar personal, living, or family expenses, regardless of whether the fee must be paid to the institution as a condition of the student's enrollment or attendance. Therefore, a required student health fee and a required transportation fee are not qualified expenses. The final regulations clarify that, as stated in the preamble to the proposed regulations, medical expenses include student health fees.

Several commentators requested clarification of how a required general fee (referred to as a *bundled fee*) should be treated in calculating the amount of qualified expenses. These commentators explained that often institutions will charge a bundled fee that includes charges for both qualified expenses and personal expenses. These commentators note that, unlike a comprehensive fee, a bundled fee normally does not include tuition charges.

Section 1.25A–2(d)(4) of the proposed regulations describes the treatment of a comprehensive fee, which typically includes charges for tuition, fees, and personal expenses. The proposed regulations provide that the portion of the comprehensive fee that is allocable to personal expenses is not a qualified expense, and require institutions to make a reasonable allocation between qualified expenses and personal expenses. One commentator recommended that the final regulations provide a similar allocation rule for bundled fees. Another commentator recommended that institutions should not be required to allocate a bundled fee that includes an insubstantial amount of personal expenses. Because personal expenses do not qualify for the education tax credit, the final regulations clarify that the allocation rule in § 1.25A–2(d)(4) applies to any required fee that combines charges for both qualified expenses and personal expenses (such as comprehensive fees and bundled fees).

One commentator noted that, under the definition of a *hobby course* in § 1.25A–2(d)(5) of the proposed regulations, one student may be enrolled in a course to receive academic credit toward a degree, another student may be enrolled in the same course on a noncredit basis to acquire or improve job skills, while a third student may be enrolled in the same course as a hobby. Under the proposed regulations, the first and second students may be eligible to claim an education tax credit, but the third student is not. Consistent with sections 25A(c)(2) and 25A(f)(1)(B), the final regulations continue to provide that expenses paid for courses that involve sports, games, or hobbies, or any noncredit course, are not qualified expenses, unless the course is part of the individual's degree program, or, in the case of the Lifetime Learning Credit, the student takes the course to acquire or improve job skills.

4. *Hope Scholarship Credit*

Several commentators requested clarification of the definition of an *eligible student* for purposes of the Hope Scholarship Credit. One commentator recommended that the *year of study requirement* in the regulations should be eliminated and that the credit should be allowed for any two years of undergraduate study. The year of study requirement derives from the statutory requirements in section 25A. Therefore, the final regulations do not adopt this recommendation.

Another commentator requested clarification as to whether a student who completes a one-year postsecondary certificate program and in a later year completes another one-year postsecondary certificate program (or enrolls in a postsecondary degree program) may claim a Hope Scholarship Credit for both years. The final regulations include a new example in § 1.25A–3(d)(2) that illustrates that the Hope Scholarship Credit is allowable for the first two years of postsecondary education, which may include two one-year certificate programs.

Commentators requested clarification of *Example 3* in § 1.25A–3(d)(2). The commentators asked if an otherwise eligible student who has not completed the first two years of undergraduate study as of the beginning of the taxable year may include qualified expenses paid during the entire taxable year in calculating the Hope Scholarship Credit, even if the student completes the first two years of undergraduate study during the year. The example has been revised to clarify that, if a student has not completed the first two years of undergraduate study as of the beginning of the taxable year, the qualified expenses paid during the entire taxable year may be taken into account in calculating the Hope Scholarship Credit. However, in no event may a Hope Scholarship Credit be claimed for more than two taxable years with respect to the same student.

5. *Special Rules Relating to Characterization and Timing of Payments*

Several commentators requested clarification of the rules for payments of qualified expenses by a third party. One commentator asked how the third party payment rule in § 1.25A–5 of the proposed regulations applies in the case of a taxpayer who, although not divorced, is not treated as married within the meaning of section 7703. The proposed regulations provide that if a third party (someone other than the taxpayer, the taxpayer's spouse, or a claimed dependent) pays qualified expenses on behalf of a student directly to an institution, the student is treated as receiving the payment from the third party and, in turn, paying the qualified expenses to the institution. The final regulations clarify that, for purposes of § 1.25A–5(b), a third party includes the spouse of a taxpayer who is not treated as married under section 7703. Thus, for example, if the taxpayer is a custodial parent who is not treated as married under section 7703, then (assuming that the taxpayer claims the student as a dependent) the taxpayer may claim an education tax credit for qualified expenses paid by the noncustodial parent on behalf of the student.

One commentator requested clarification as to whether an education tax credit is allowable for the amount of any tuition reduction provided by an eligible educational institution to its employees, or their spouses or dependent children. The final regulations provide in § 1.25A–5(b)(2) that an education tax credit is allowable for the amount of any reduction in tuition only if the amount of the tuition reduction is included in the employee's gross income.

Several commentators requested clarification of the rules in § 1.25A–5(c) of the proposed regulations for reducing the amount of qualified expenses paid during the taxable year by the amount of certain tax-free educational assistance (including any qualified scholarship that is excludable from gross income under section 117) received during the taxable year. The pro-

posed regulations provide a rule for allocating scholarships between qualified expenses and expenses that do not qualify for an education tax credit under section 25A (nonqualified expenses). The proposed regulations provide that a scholarship will be treated as allocated to qualified expenses, and thus as a qualified scholarship that reduces qualified expenses, unless the student includes the scholarship in income or the terms of the scholarship require that it be applied to nonqualified expenses.

Several commentators asked whether a student may choose to include in income a restricted scholarship that, by its terms, must be used to pay qualified expenses and claim an education tax credit for qualified expenses covered by the scholarship. The test for purposes of section 25A is whether the scholarship is excludable from gross income under section 117, and not whether the student elects to include the scholarship in income. The legislative history to section 25A states that qualified expenses do not include expenses covered by "education assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit." See H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess., at 343 (1997). Section 117 provides, in general, that gross income shall not include a scholarship that, consistent with the terms of the scholarship, is used to pay certain qualified expenses. A restricted scholarship that must be used to pay qualified expenses is a qualified scholarship excludable under section 117. Therefore, for purposes of section 25A, a restricted scholarship that must be used to pay qualified expenses reduces the amount of qualified expenses that may be taken into account in calculating the education tax credit.

An unrestricted scholarship that may be used to pay any of the student's costs of attendance (such as room and board and any other incidental expenses) is excludable from gross income only if used to pay qualified expenses. To the extent that an unrestricted scholarship, or a portion thereof, is used to pay nonqualified expenses and such use is consistent with the terms of the scholarship, the scholarship is not a qualified scholarship excludable under section 117. In this situation, the scholarship is included in gross income and will not reduce the amount of qualified expenses that may be taken into account in calculating the education tax credit. The final regulations clarify that, for purposes of section 25A, a scholarship or fellowship grant is treated as a qualified scholarship excludable under section 117 (thereby reducing the amount of qualified expenses) except to the extent: (1) the scholarship may be applied, by its terms, to expenses other than qualified expenses (such as room and board) and the student reports the scholarship as income; or (2) the scholarship must be applied, by its terms, to expenses other than qualified expenses (such as room and board) and the student reports the scholarship as income.

One commentator recommended that the final regulations provide that loans are not excludable educational assistance within the meaning of § 1.25A–5(c), and do not reduce the amount of qualified expenses. Section 1.25A–5(e)(3) of the proposed regulations specifically provides that amounts paid with loan proceeds may qualify for the education tax credit. In addition, an example in § 1.25A–5(c)(4) of the proposed regulations provides that a loan is not tax-free educational assistance within the meaning of § 1.25A–5(c). The final regulations retain these specific provisions on loans.

The proposed regulations provide that expenses paid with loan proceeds disbursed directly to an institution are, in general, treated as paid on the date of the disbursement of the proceeds. Several commentators recommended that, in accordance with the Department of Education regulations in 34 CFR 668.164(a), the date of disbursement should be the date the institution credits the student's account with the loan proceeds and not the date the lender disburses the loan proceeds to the institution. In general, 34 CFR 668.164 regulates the disbursement of federal student loans under Title IV of the Higher Education Act of 1965 (including the Federal Perkins Loan, Federal Family Education Loan, and William D. Ford Direct Loan Program). These rules require an institution to verify that a student is enrolled and is otherwise eligible to receive the loan proceeds before crediting the student's account or releasing the funds to the student. Consistent with these Department of Education rules, the final regulations clarify that the qualified expenses paid with loan proceeds disbursed directly to an institution are treated as paid at the time the loan proceeds are actually credited to the student's account. In the case of Title IV loan programs, Department of Education rules require the institution to notify the borrower of the date and the amount of the disbursement at the time the institution credits the student's account. See 34 CFR 668.165(a)(2). However, the final regulations provide that if the taxpayer does not know the date the institution credits the student's account, the taxpayer must treat the expenses as paid on the last date for payment prescribed by the institution.

Several commentators requested clarification as to when a taxpayer may claim an education tax credit for qualified expenses paid through a third party installment payment plan. One commentator explained that institutions and taxpayers may contract with a third party installment payment company to provide an installment payment plan for the institution's students. The commentator explained that, in general, the company agrees to collect tuition payments over a period of time (usually 10 months) and remit the payments to the institution on a predetermined schedule. The commentator asked whether a taxpayer is treated as paying the qualified expenses when the taxpayer pays the third party installment payment company, or when the third party disburses the funds to the institution. The final regulations clarify that when the expenses are treated as paid for purposes of section 25A depends on whether, under the terms of the installment payment agreement, the third party is acting as an agent of the taxpayer or as an agent of the institution.

One commentator requested clarification as to whether an education tax credit is allowable for any amounts paid for qualified expenses that are retained by the institution, under the institution's refund policy, when the student withdraws. Section 1.25A–5(f)(1) of the proposed regulations provides that the amount of qualified expenses is calculated by adding all the qualified expenses paid for the year, and subtracting any refund received from the institution during the same year. The final regulations retain this rule. Therefore, amounts required to be paid for enrollment or attendance are qualified expenses to the extent that such amounts are not refunded when the student withdraws. The final regulations add a new paragraph § 1.25A–5(f)(4) to clarify that, with re-

spect to qualified expenses paid with the proceeds of a loan, any refund of loan proceeds by the institution back to the lender on behalf of the borrower is treated as a refund of qualified expenses.

The proposed regulations provide that if a taxpayer receives a refund of qualified expenses paid in a prior taxable year before the taxpayer files a federal income tax return for the prior year, the amount of qualified expenses for the prior taxable year is reduced by the amount of the refund. One commentator suggested that the taxpayer should have the option of claiming the credit for the full amount of qualified expenses paid in the prior taxable year and then recapturing the credit on the return filed for the taxable year in which the refund was received. The rule in the proposed regulations is intended to simplify the calculation of the education tax credit by avoiding the need to recompute the allowable education tax credit in a later year and report any resulting increase in tax. Therefore, the final regulations do not adopt the recommendation.

The final regulations clarify that, in the case of a payment of qualified expenses in one taxable year and a refund of qualified expenses in a subsequent taxable year, the recapture amount for the refund year is the difference in tax liability for the prior taxable year (taking into account any redetermination of such tax liability by audit or amended return) that results when the tax liability for the prior year is calculated using the taxpayer's redetermined credit.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of the regulations is Donna Welch, Office of Associate Chief Counsel (Procedure & Administration), Administrative Provisions & Judicial Practice Division. However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.25A–1 also issued under section 26 U.S.C. 25A(i).

Section 1.25A–2 also issued under section 26 U.S.C. 25A(i).

Section 1.25A–3 also issued under section 26 U.S.C. 25A(i).

Section 1.25A–4 also issued under section 26 U.S.C. 25A(i).

Section 1.25A–5 also issued under section 26 U.S.C. 25A(i). * * *

Par. 2. Sections 1.25A–0 through 1.25A–5 are added to read as follows:

§ 1.25A–0 Table of contents.

This section lists captions contained in §§ 1.25A–1, 1.25A–2, 1.25A–3, 1.25A–4, and 1.25A–5.

§ 1.25A–1 Calculation of education tax credit and general eligibility requirements.

(a) Amount of education tax credit.

(b) Coordination of Hope Scholarship Credit and Lifetime Learning Credit.

(1) In general.

(2) Hope Scholarship Credit.

(3) Lifetime Learning Credit.

(4) Examples.

(c) Limitation based on modified adjusted gross income.

(1) In general.

(2) Modified adjusted gross income defined.

(3) Inflation adjustment.

(d) Election.

(e) Identification requirement.

(f) Claiming the credit in the case of a dependent.

(1) In general.

(2) Examples.

(g) Married taxpayers.

(h) Nonresident alien taxpayers and dependents.

§ 1.25A–2 Definitions.

(a) Claimed dependent.

(b) Eligible educational institution.

(1) In general.

(2) Rules on federal financial aid programs.

(c) Academic period.

(d) Qualified tuition and related expenses.

(1) In general.

(2) Required fees.

(i) In general.

(ii) Books, supplies, and equipment.

(iii) Nonacademic fees.

(3) Personal expenses.

(4) Treatment of a comprehensive or bundled fee.

(5) Hobby courses.

(6) Examples.

§ 1.25A–3 Hope Scholarship Credit.

(a) Amount of the credit.

(1) In general.

(2) Maximum credit.

(b) Per student credit.

(1) In general.

(2) Example.

(c) Credit allowed for only two taxable years.

(d) Eligible student.

(1) Eligible student defined.

(i) Degree requirement.

(ii) Work load requirement.

(iii) Year of study requirement.

(iv) No felony drug conviction.

(2) Examples.

(e) Academic period for prepayments.

(1) In general.

(2) Example.

(f) Effective date.

§ 1.25A–4 Lifetime Learning Credit.

(a) Amount of the credit.

(1) Taxable years beginning before January 1, 2003.

(2) Taxable years beginning after December 31, 2002.

(3) Coordination with the Hope Scholarship Credit.

(4) Examples.

(b) Credit allowed for unlimited number of taxable years.

(c) Both degree and nondegree courses are eligible for the credit.

(1) In general.

(2) Examples.

(d) Effective date.

§ 1.25A–5 Special rules relating to characterization and timing of payments.

(a) Educational expenses paid by claimed dependent.

(b) Educational expenses paid by a third party.

(1) In general.

(2) Special rule for tuition reduction included in gross income of employee.

(3) Examples.

(c) Adjustment to qualified tuition and related expenses for certain excludable educational assistance.

(1) In general.

(2) No adjustment for excludable educational assistance attributable to expenses paid in a prior year.

(3) Scholarships and fellowship grants.

(4) Examples.

(d) No double benefit.

(e) Timing rules.

(1) In general.

(2) Prepayment rule.

(i) In general.

(ii) Example.

(3) Expenses paid with loan proceeds.

(4) Expenses paid through third party installment payment plans.

(i) In general.

(ii) Example.

(f) Refund of qualified tuition and related expenses.

(1) Payment and refund of qualified tuition and related expenses in the same taxable year.

(2) Payment of qualified tuition and related expenses in one taxable year and refund in subsequent taxable year before return filed for prior taxable year.

(3) Payment of qualified tuition and related expenses in one taxable year and refund in subsequent taxable year.

(i) In general.

(ii) Recapture amount.

(4) Refund of loan proceeds treated as refund of qualified tuition and related expenses.

(5) Excludable educational assistance received in a subsequent taxable year treated as a refund.

(6) Examples.

§ 1.25A–1 Calculation of education tax credit and general eligibility requirements.

(a) *Amount of education tax credit.* An individual taxpayer is allowed a nonrefundable education tax credit against income tax imposed by chapter 1 of the Internal Revenue Code for the taxable year. The amount of the education tax credit is the total of the Hope Scholarship Credit (as described in § 1.25A–3) plus the Lifetime Learning Credit (as described in § 1.25A–4). For limitations on the credits allowed by subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code, see section 26.

(b) *Coordination of Hope Scholarship Credit and Lifetime Learning Credit*—(1) *In general.* In the same taxable year, a taxpayer may claim a Hope Scholarship Credit for each eligible student's qualified tuition and related expenses (as defined in § 1.25A–2(d)) and a Lifetime Learning Credit for one or more other students' qualified tuition and related expenses. However, a taxpayer may not claim both a Hope Scholarship Credit and a Lifetime Learning Credit with respect to the same student in the same taxable year.

(2) *Hope Scholarship Credit.* Subject to certain limitations, a Hope Scholarship Credit may be claimed for the qualified tuition and related expenses paid during a taxable year with respect to each eligible student (as defined in § 1.25A–3(d)). Qualified tuition and related expenses paid during a taxable year with respect to one student may not be taken into account in computing the amount of the Hope Scholarship Credit with respect to any other student. In addition, qualified tuition and related expenses paid during a taxable year with respect to any student for whom a Hope Scholarship Credit is claimed may not be taken into account in computing the amount of the Lifetime Learning Credit.

(3) *Lifetime Learning Credit.* Subject to certain limitations, a Lifetime Learning Credit may be claimed for the aggregate amount of qualified tuition and related expenses paid during a taxable year with respect to students for whom no Hope Scholarship Credit is claimed.

(4) *Examples.* The following examples illustrate the rules of this paragraph (b):

Example 1. In 1999, Taxpayer A pays qualified tuition and related expenses for his dependent, B, to attend College Y during 1999. Assuming all other relevant requirements are met, Taxpayer A may claim either a Hope Scholarship Credit or a Lifetime Learning Credit with respect to dependent B, but not both. See § 1.25A–3(a) and § 1.25A–4(a).

Example 2. In 1999, Taxpayer C pays $2,000 in qualified tuition and related expenses for her dependent, D, to attend College Z during 1999. In 1999, Taxpayer C also pays $500 in qualified tuition and related expenses to attend a computer course during 1999 to improve Taxpayer C's job skills. Assuming all other relevant requirements are met, Taxpayer C may claim a Hope Scholarship Credit for the $2,000 of qualified tuition and related expenses attributable to dependent D (see § 1.25A–3(a)) and a Lifetime Learning Credit (see §1.25A–4(a)) for the $500 of qualified tuition and related expenses incurred to improve her job skills.

Example 3. The facts are the same as in *Example 2*, except that Taxpayer C pays $3,000 in qualified tuition and related expenses for her dependent, D, to attend College Z during 1999. Although a Hope Scholarship Credit is available only with respect to the first $2,000 of qualified tuition and related expenses paid with respect to D (see § 1.25A–3(a)), Taxpayer C may not add the $1,000 of excess expenses to her $500 of qualified tuition and related expenses in computing the amount of the Lifetime Learning Credit.

(c) *Limitation based on modified adjusted gross income*—(1) *In general.* The education tax credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income between $40,000 and $50,000 ($80,000 and $100,000 for married individuals who file a joint return). Thus, taxpayers with modified adjusted gross income above $50,000 (or $100,000 for joint filers) may not claim an education tax credit.

(2) *Modified adjusted gross income defined.* The term *modified adjusted gross income* means the adjusted gross income (as defined in section 62) of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933 (relating to income earned abroad or from certain U.S. possessions or Puerto Rico).

(3) *Inflation adjustment.* For taxable years beginning after 2001, the amounts in paragraph (c)(1) of this section will be increased for inflation occurring after 2000 in accordance with section 1(f)(3). If any amount adjusted under this paragraph (c)(3) is not a multiple of $1,000, the amount will be rounded to the next lowest multiple of $1,000.

(d) *Election.* No education tax credit is allowed unless a taxpayer elects to claim the credit on the taxpayer's federal income tax return for the taxable year in

which the credit is claimed. The election is made by attaching Form 8863, *"Education Credits (Hope and Lifetime Learning Credits),"* to the federal income tax return.

(e) *Identification requirement.* No education tax credit is allowed unless a taxpayer includes on the federal income tax return claiming the credit the name and the taxpayer identification number of the student for whom the credit is claimed. For rules relating to assessment for an omission of a correct taxpayer identification number, see sections 6213(b) and (g)(2)(J).

(f) *Claiming the credit in the case of a dependent*—(1) *In general.* If a student is a claimed dependent of another taxpayer, only that taxpayer may claim the education tax credit for the student's qualified tuition and related expenses. However, if another taxpayer is eligible to, but does not, claim the student as a dependent, only the student may claim the education tax credit for the student's qualified tuition and related expenses.

(2) *Examples.* The following examples illustrate the rules of this paragraph (f):

Example 1. In 1999, Taxpayer A pays qualified tuition and related expenses for his dependent, B, to attend University Y during 1999. Taxpayer A claims B as a dependent on his federal income tax return. Therefore, assuming all other relevant requirements are met, Taxpayer A is allowed an education tax credit on his federal income tax return, and B is not allowed an education tax credit on B's federal income tax return. The result would be the same if B paid the qualified tuition and related expenses. See § 1.25A–5(a).

Example 2. In 1999, Taxpayer C has one dependent, D. In 1999, D pays qualified tuition and related expenses to attend University Z during 1999. Although Taxpayer C is eligible to claim D as a dependent on her federal income tax return, she does not do so. Therefore, assuming all other relevant requirements are met, D is allowed an education tax credit on D's federal income tax return, and Taxpayer C is not allowed an education tax credit on her federal income tax return, with respect to D's education expenses. The result would be the same if C paid the qualified tuition and related expenses on behalf of D. See § 1.25A–5(b).

(g) *Married taxpayers.* If a taxpayer is married (within the meaning of section 7703), no education tax credit is allowed to the taxpayer unless the taxpayer and the taxpayer's spouse file a joint federal income tax return for the taxable year.

(h) *Nonresident alien taxpayers and dependents.* If a taxpayer or the taxpayer's spouse is a nonresident alien for any portion of the taxable year, no education tax credit is allowed unless the nonresident alien is treated as a resident alien by reason of an election under section 6013(g) or (h). In addition, if a student is a nonresident alien, a taxpayer may not claim an education tax credit with respect to the qualified tuition and related expenses of the student unless the student is a claimed dependent (as defined in § 1.25A–2(a)).

§ 1.25A–2 Definitions.

(a) *Claimed dependent.* A *claimed dependent* means a dependent (as defined in section 152) for whom a deduction under section 151 is allowed on a taxpayer's federal income tax return for the taxable year. Among other requirements under section 152, a nonresident alien student must be a resident of a country contiguous to the United States in order to be treated as a dependent.

(b) *Eligible educational institution*—(1) *In general.* In general, an *eligible educational institution* means a college, university, vocational school, or other postsecondary educational institution that is—

(i) Described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) as in effect on August 5, 1997, (generally all accredited public, nonprofit, and proprietary postsecondary institutions); and

(ii) Participating in a federal financial aid program under title IV of the Higher Education Act of 1965 or is certified by the Department of Education as eligible to participate in such a program but chooses not to participate.

(2) *Rules on federal financial aid programs.* For rules governing an educational institution's eligibility to participate in federal financial aid programs, see 20 U.S.C. 1070; 20 U.S.C. 1094; and 34 CFR 600 and 668.

(c) *Academic period. Academic period* means a quarter, semester, trimester, or other period of study as reasonably determined by an eligible educational institution. In the case of an eligible educational institution that uses credit hours or clock hours, and does not have academic terms, each payment period (as defined in 34 CFR 668.4, revised as of July 1, 2002) may be treated as an academic period.

(d) *Qualified tuition and related expenses*—(1) *In general. Qualified tuition and related expenses* means tuition and fees required for the enrollment or attendance of a student for courses of instruction at an eligible educational institution.

(2) *Required fees*—(i) *In general.* Except as provided in paragraph (d)(3) of this section, the test for determining whether any fee is a qualified tuition and related expense is whether the fee is required to be paid to the eligible educational institution as a condition of the student's enrollment or attendance at the institution.

(ii) *Books, supplies, and equipment.* Qualified tuition and related expenses include fees for books, supplies, and equipment used in a course of study only if the fees must be paid to the eligible educational institution for the enrollment or attendance of the student at the institution.

(iii) *Nonacademic fees.* Except as provided in paragraph (d)(3) of this section, qualified tuition and related expenses include fees charged by an eligible educational institution that are not used directly for, or allocated to, an academic course of instruction only if the fee must be paid to the eligible educational institution for the enrollment or attendance of the student at the institution.

(3) *Personal expenses.* Qualified tuition and related expenses do not include the costs of room and board, insurance, medical expenses (including student health fees), transportation, and similar personal, living, or family expenses, regardless of whether the fee must be paid to the eligible educational institution for the enrollment or attendance of the student at the institution.

(4) *Treatment of a comprehensive or bundled fee.* If a student is required to pay a fee (such as a comprehensive fee or a bundled fee) to an eligible educational institution that combines charges for qualified tuition and related expenses with charges for personal expenses described in paragraph (d)(3) of this section, the portion of the fee that is allocable to personal expenses is not included in qualified tuition and related expenses. The determination of what portion of the fee relates to qualified tuition and related expenses and what portion relates to personal expenses must be made by the institution using a reasonable method of allocation.

(5) *Hobby courses.* Qualified tuition and related expenses do not include expenses that relate to any course of instruction or other education that involves sports, games, or hobbies, or any noncredit course, unless the course or other education is part of the student's degree program, or in the case of the Lifetime Learning Credit, the student takes the course to acquire or im-

prove job skills.

(6) *Examples.* The following examples illustrate the rules of this paragraph (d). In each example, assume that the institution is an eligible educational institution and that all other relevant requirements to claim an education tax credit are met. The examples are as follows:

Example 1. University V offers a degree program in dentistry. In addition to tuition, all students enrolled in the program are required to pay a fee to University V for the rental of dental equipment. Because the equipment rental fee must be paid to University V for enrollment and attendance, the tuition and the equipment rental fee are qualified tuition and related expenses.

Example 2. First-year students at College W are required to obtain books and other reading materials used in its mandatory first-year curriculum. The books and other reading materials are not required to be purchased from College W and may be borrowed from other students or purchased from off-campus bookstores, as well as from College W's bookstore. College W bills students for any books and materials purchased from College W's bookstore. The fee that College W charges for the first-year books and materials purchased at its bookstore is not a qualified tuition and related expense because the books and materials are not required to be purchased from College W for enrollment or attendance at the institution.

Example 3. All students who attend College X are required to pay a separate student activity fee in addition to their tuition. The student activity fee is used solely to fund on-campus organizations and activities run by students, such as the student newspaper and the student government (no portion of the fee covers personal expenses). Although labeled as a student activity fee, the fee is required for enrollment or attendance at College X. Therefore, the fee is a qualified tuition and related expense.

Example 4. The facts are the same as in *Example 3*, except that College X offers an optional athletic fee that students may pay to receive discounted tickets to sports events. The athletic fee is not required for enrollment or attendance at College X. Therefore, the fee is not a qualified tuition and related expense.

Example 5. College Y requires all students to live on campus. It charges a single comprehensive fee to cover tuition, required fees, and room and board. Based on College Y's reasonable allocation, sixty percent of the comprehensive fee is allocable to tuition and other required fees not allocable to personal expenses, and the remaining forty percent of the comprehensive fee is allocable to charges for room and board and other personal expenses. Therefore, only sixty percent of College Y's comprehensive fee is a qualified tuition and related expense.

Example 6. As a degree student at College Z, Student A is required to take a certain number of courses outside of her chosen major in Economics. To fulfill this requirement, Student A enrolls in a square dancing class offered by the Physical Education Department. Because Student A receives credit toward her degree program for the square dancing class, the tuition for the square dancing class is included in qualified tuition and related expenses.

§ 1.25A–3 Hope Scholarship Credit.

(a) *Amount of the credit*—(1) *In general.* Subject to the phaseout of the education tax credit described in § 1.25A–1(c), the Hope Scholarship Credit amount is the total of—

(i) 100 percent of the first $1,000 of qualified tuition and related expenses paid during the taxable year for education furnished to an eligible student (as defined in paragraph (d) of this section) who is the taxpayer, the taxpayer's spouse, or any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year, see § 1.25A–5(e)(2)); plus

(ii) 50 percent of the next $1,000 of such expenses paid with respect to that student.

(2) *Maximum credit.* For taxable years beginning before 2002, the maximum Hope Scholarship Credit allowed for each eligible student is $1,500. For taxable years beginning after 2001, the amounts used in paragraph (a)(1) of this section to determine the maximum credit will be increased for inflation occurring after 2000 in accordance with section 1(f)(3). If any amount adjusted under this paragraph (a)(2) is not a multiple of $100, the amount will be rounded to the next lowest multiple of $100.

(b) *Per student credit*—(1) *In general.* A Hope Scholarship Credit may be claimed for the qualified tuition and related expenses of each eligible student (as defined in paragraph (d) of this section).

(2) *Example.* The following example illustrates the rule of this paragraph (b). In the example, assume that all the requirements to claim an education tax credit are met. The example is as follows:

Example. In 1999, Taxpayer A has two dependents, B and C, both of whom are eligible students. Taxpayer A pays $1,600 in qualified tuition and related expenses for dependent B to attend a community college. Taxpayer A pays $5,000 in qualified tuition and related expenses for dependent C to attend University X. Taxpayer A may claim a Hope Scholarship Credit of $1,300 ($1,000 + (.50 x $600)) for dependent B, and the maximum $1,500 Hope Scholarship Credit for dependent C, for a total Hope Scholarship Credit of $2,800.

(c) *Credit allowed for only two taxable years.* For each eligible student, the Hope Scholarship Credit may be claimed for no more than two taxable years.

(d) *Eligible student*—(1) *Eligible student defined.* For purposes of the Hope Scholarship Credit, the term *eligible student* means a student who satisfies all of the following requirements—

(i) *Degree requirement.* For at least one academic period that begins during the taxable year, the student enrolls at an eligible educational institution in a program leading toward a postsecondary degree, certificate, or other recognized postsecondary educational credential;

(ii) *Work load requirement.* For at least one academic period that begins during the taxable year, the student enrolls for at least one-half of the normal full-time work load for the course of study the student is pursuing. The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard for half-time may not be lower than the applicable standard for half-time established by the Department of Education under the Higher Education Act of 1965 and set forth in 34 CFR 674.2(b) (revised as of July 1, 2002) for a half-time undergraduate student;

(iii) *Year of study requirement.* As of the beginning of the taxable year, the student has not completed the first two years of postsecondary education at an eligible educational institution. Whether a student has completed the first two years of postsecondary education at an eligible educational institution as of the beginning of a taxable year is determined based on whether the institution in which the student is enrolled in a degree program (as described in paragraph (d)(1)(i) of this section) awards the student two years of academic credit at that institution for postsecondary course work completed by the student prior to the beginning of the taxable year. Any academic credit awarded by the eligible educational institution solely on the basis of the student's performance on proficiency examinations is disregarded in determining whether the student has completed two years of postsecondary education; and

(iv) *No felony drug conviction.* The student has not been convicted of a federal or state felony offense for possession or distribution of a controlled substance as of the end of the taxable year for which the credit is claimed.

(2) *Examples.* The following examples illustrate the rules of this paragraph (d). In each example, assume that the student has not been convicted of a felony drug offense, that the institution is an eligible educational institution unless otherwise stated,

that the qualified tuition and related expenses are paid during the same taxable year that the academic period begins, and that a Hope Scholarship Credit has not previously been claimed for the student (see paragraph (c) of this section). The examples are as follows:

Example 1. Student A graduates from high school in June 1998 and is enrolled in an undergraduate degree program at College U for the 1998 Fall semester on a full-time basis. For the 1999 Spring semester, Student A again is enrolled at College U on a full-time basis. For the 1999 Fall semester, Student A is enrolled in less than half the normal full-time course work for her degree program. Because Student A is enrolled in an undergraduate degree program on at least a half-time basis for at least one academic period that begins during 1998 and at least one academic period that begins during 1999, Student A is an eligible student for taxable years 1998 and 1999 (including the 1999 Fall semester when Student A enrolls at College U on less than a half-time basis).

Example 2. Prior to 1998, Student B attended college for several years on a full-time basis. Student B transfers to College V for the 1998 Spring semester. College V awards Student B credit for some (but not all) of the courses he previously completed, and College V classifies Student B as a first-semester sophomore. During both the Spring and Fall semesters of 1998, Student B is enrolled in at least one-half the normal full-time work load for his degree program at College V. Because College V does not classify Student B as having completed the first two years of postsecondary education as of the beginning of 1998, Student B is an eligible student for taxable year 1998.

Example 3. The facts are the same as in *Example 2.* After taking classes on a half-time basis for the 1998 Spring and Fall semesters, Student B is enrolled at College V for the 1999 Spring semester on a full-time basis. College V classifies Student B as a second-semester sophomore for the 1999 Spring semester and as a first-semester junior for the 1999 Fall semester. Because College V does not classify Student B as having completed the first two years of postsecondary education as of the beginning of 1999, Student B is an eligible student for taxable year 1999. Therefore, the qualified expenses and required fees paid for the 1999 Spring semester and the 1999 Fall semester are taken into account in calculating any Hope Scholarship Credit.

Example 4. Prior to 1998, Student C was not enrolled at another eligible educational institution. At the time that Student C enrolls in a degree program at College W for the 1998 Fall semester, Student C takes examinations to demonstrate her proficiency in several subjects. On the basis of Student C's performance on these examinations, College W classifies Student C as a second-semester sophomore as of the beginning of the 1998 Fall semester. Student C is enrolled at College W during the 1998 Fall semester and during the 1999 Spring and Fall semesters on a full-time basis and is classified as a first-semester junior as of the beginning of the 1999 Spring semester. Because Student C was not enrolled in a college or other eligible educational institution prior to 1998 (but rather was awarded three semesters of academic credit solely because of proficiency examinations), Student C is not treated as having completed the first two years of postsecondary education at an eligible educational institution as of the beginning of 1998 or as of the beginning of 1999. Therefore, Student C is an eligible student for both taxable years 1998 and 1999.

Example 5. During the 1998 Fall semester, Student D is a high school student who takes classes on a half-time basis at College X. Student D is not enrolled as part of a degree program at College X because College X does not admit students to a degree program unless the student has a high school diploma or equivalent. Because Student D is not enrolled in a degree program at College X during 1998, Student D is not an eligible student for taxable year 1998.

Example 6. The facts are the same as in *Example 5.* In addition, during the 1999 Spring semester, Student D again attends College X but not as part of a degree program. Student D graduates from high school in June 1999. For the 1999 Fall semester, Student D enrolls in College X as part of a degree program, and College X awards Student D credit for her prior course work at College X. During the 1999 Fall semester, Student D is enrolled in more than one-half the normal full-time work load of courses for her degree program at College X. Because Student D is enrolled in a degree program at College X for the 1999 Fall term on at least a half-time basis, Student D is an eligible student for all of taxable year 1999. Therefore, the qualified tuition and required fees paid for classes taken at College X during both the 1999 Spring semester (during which Student D was not enrolled in a degree program) and the 1999 Fall semester are taken into account in computing any Hope Scholarship Credit.

Example 7. Student E completed two years of undergraduate study at College S. College S is not an eligible educational institution for purposes of the education tax credit. At the end of 1998, Student E enrolls in an undergraduate degree program at College Z, an eligible educational institution, for the 1999 Spring semester on a full-time basis. College Z awards Student E two years of academic credit for his previous course work at College S and classifies Student E as a first-semester junior for the 1999 Spring semester. Student E is treated as having completed the first two years of postsecondary education at an eligible educational institution as of the beginning of 1999. Therefore, Student E is not an eligible student for taxable year 1999.

Example 8. Student F received a degree in 1998 from College R. College R is not an eligible educational institution for purposes of the education tax credit. During 1999, Student F is enrolled in a graduate-degree program at College Y, an eligible educational institution, for the 1999 Fall semester on a full-time basis. By admitting Student F to its graduate degree program, College Y treats Student F as having completed the first two years of postsecondary education as of the beginning of 1999. Therefore, Student F is not an eligible student for taxable year 1999.

Example 9. Student G graduates from high school in June 2001. In January 2002, Student G is enrolled in a one-year postsecondary certificate program on a full-time basis to obtain a certificate as a travel agent. Student G completes the program in December 2002 and is awarded a certificate. In January 2003, Student G enrolls in a one-year postsecondary certificate program on a full-time basis to obtain a certificate as a computer programer. Student G meets the degree requirement, the work load requirement, and the year of study requirement for the taxable years 2002 and 2003. Therefore, Student G is an eligible student for both taxable years 2002 and 2003.

(e) *Academic period for prepayments*—(1) *In general.* For purposes of determining whether a student meets the requirements in paragraph (d) of this section for a taxable year, if qualified tuition and related expenses are paid during one taxable year for an academic period that begins during January, February or March of the next taxable year (for taxpayers on a fiscal taxable year, use the first three months of the next taxable year), the academic period is treated as beginning during the taxable year in which the payment is made.

(2) *Example.* The following example illustrates the rule of this paragraph (e). In the example, assume that all the requirements to claim a Hope Scholarship Credit are met. The example is as follows:

Example. Student G graduates from high school in June 1998. After graduation, Student G works full-time for several months to earn money for college. Student G is enrolled on a full-time basis in an undergraduate degree program at University W, an eligible educational institution, for the 1999 Spring semester, which begins in January 1999. Student G pays tuition to University W for the 1999 Spring semester in December 1998. Because the tuition paid by Student G in 1998 relates to an academic period that begins during the first three months of 1999, Student G's eligibility to claim a Hope Scholarship Credit in 1998 is determined as if the 1999 Spring semester began in 1998. Thus, assuming Student G has not been convicted of a felony drug offense as of December 31, 1998, Student G is an eligible student for 1998.

(f) *Effective date.* The Hope Scholarship Credit is applicable for qualified tuition and related expenses paid after December 31, 1997, for education furnished in academic periods beginning after December 31, 1997.

§ 1.25A–4 Lifetime Learning Credit.

(a) *Amount of the credit*—(1) *Taxable years beginning before January 1, 2003.* Subject to the phaseout of the education tax credit described in § 1.25A–1(c), for taxable years beginning before 2003, the Lifetime Learning Credit amount is 20 percent of up to $5,000 of qualified tuition and related expenses paid during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, and any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year, see § 1.25A–5(e)(2)).

(2) *Taxable years beginning after December 31, 2002.* Subject to the phaseout

of the education tax credit described in § 1.25A–1(c), for taxable years beginning after 2002, the Lifetime Learning Credit amount is 20 percent of up to $10,000 of qualified tuition and related expenses paid during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, and any claimed dependent during any academic period beginning in the taxable year (or treated as beginning in the taxable year, see § 1.25A–5(e)(2)).

(3) *Coordination with the Hope Scholarship Credit.* Expenses paid with respect to a student for whom the Hope Scholarship Credit is claimed are not eligible for the Lifetime Learning Credit.

(4) *Examples.* The following examples illustrate the rules of this paragraph (a). In each example, assume that all the requirements to claim a Lifetime Learning Credit or a Hope Scholarship Credit, as applicable, are met. The examples are as follows:

Example 1. In 1999, Taxpayer A pays qualified tuition and related expenses of $3,000 for dependent B to attend an eligible educational institution, and Taxpayer A pays qualified tuition and related expenses of $4,000 for dependent C to attend an eligible educational institution. Taxpayer A does not claim a Hope Scholarship Credit with respect to either B or C. Although Taxpayer A paid $7,000 of qualified tuition and related expenses during the taxable year, Taxpayer A may claim the Lifetime Learning Credit with respect to only $5,000 of such expenses. Therefore, the maximum Lifetime Learning Credit Taxpayer A may claim for 1999 is $1,000 (.20 x $5,000).

Example 2. In 1999, Taxpayer D pays $6,000 of qualified tuition and related expenses for dependent E, and $2,000 of qualified tuition and related expenses for dependent F, to attend eligible educational institutions. Dependent F has already completed the first two years of postsecondary education. For 1999, Taxpayer D claims the maximum $1,500 Hope Scholarship Credit with respect to dependent E. In computing the amount of the Lifetime Learning Credit, Taxpayer D may not include any of the $6,000 of qualified tuition and related expenses paid on behalf of dependent E but may include the $2,000 of qualified tuition and related expenses of dependent F.

(b) *Credit allowed for unlimited number of taxable years.* There is no limit to the number of taxable years that a taxpayer may claim a Lifetime Learning Credit with respect to any student.

(c) *Both degree and nondegree courses are eligible for the credit*—(1) *In general.* For purposes of the Lifetime Learning Credit, amounts paid for a course at an eligible educational institution are qualified tuition and related expenses if the course is either part of a postsecondary degree program or is not part of a postsecondary degree program but is taken by the student to acquire or improve job skills.

(2) *Examples.* The following examples illustrate the rule of this paragraph (c). In each example, assume that all the requirements to claim a Lifetime Learning Credit are met. The examples are as follows:

Example 1. Taxpayer A, a professional photographer, enrolls in an advanced photography course at a local community college. Although the course is not part of a degree program, Taxpayer A enrolls in the course to improve her job skills. The course fee paid by Taxpayer A is a qualified tuition and related expense for purposes of the Lifetime Learning Credit.

Example 2. Taxpayer B, a stockbroker, plans to travel abroad on a "photo-safari" for his next vacation. In preparation for the trip, Taxpayer B enrolls in a noncredit photography class at a local community college. Because Taxpayer B is not taking the photography course as part of a degree program or to acquire or improve his job skills, amounts paid by Taxpayer B for the course are not qualified tuition and related expenses for purposes of the Lifetime Learning Credit.

(d) *Effective date.* The Lifetime Learning Credit is applicable for qualified tuition and related expenses paid after June 30, 1998, for education furnished in academic periods beginning after June 30, 1998.

§ 1.25A–5 Special rules relating to characterization and timing of payments.

(a) *Educational expenses paid by claimed dependent.* For any taxable year for which the student is a claimed dependent of another taxpayer, qualified tuition and related expenses paid by the student are treated as paid by the taxpayer to whom the deduction under section 151 is allowed.

(b) *Educational expenses paid by a third party*—(1) *In general.* Solely for purposes of section 25A, if a third party (someone other than the taxpayer, the taxpayer's spouse if the taxpayer is treated as married within the meaning of section 7703, or a claimed dependent) makes a payment directly to an eligible educational institution to pay for a student's qualified tuition and related expenses, the student is treated as receiving the payment from the third party and, in turn, paying the qualified tuition and related expenses to the institution.

(2) *Special rule for tuition reduction included in gross income of employee.* Solely for purposes of section 25A, if an eligible educational institution provides a reduction in tuition to an employee of the institution (or to the spouse or dependent child of an employee, as described in section 132(h)(2)) and the amount of the tuition reduction is included in the employee's gross income, the employee is treated as receiving payment of an amount equal to the tuition reduction and, in turn, paying such amount to the institution.

(3) *Examples.* The following examples illustrate the rules of this paragraph (b). In each example, assume that all the requirements to claim an education tax credit are met. The examples are as follows:

Example 1. Grandparent D makes a direct payment to an eligible educational institution for Student E's qualified tuition and related expenses. Student E is not a claimed dependent in 1999. For purposes of claiming an education tax credit, Student E is treated as receiving the money from her grandparent and, in turn, paying her qualified tuition and related expenses.

Example 2. Under a court-approved divorce decree, Parent A is required to pay Student C's college tuition. Parent A makes a direct payment to an eligible educational institution for Student C's 1999 tuition. Under paragraph (b)(1) of this section, Student C is treated as receiving the money from Parent A and, in turn, paying the qualified tuition and related expenses. Under the divorce decree, Parent B has custody of Student C for 1999. Parent B properly claims Student C as a dependent on Parent B's 1999 federal income tax return. Under paragraph (a) of this section, expenses paid by Student C are treated as paid by Parent B. Thus, Parent B may claim an education tax credit for the qualified tuition and related expenses paid directly to the institution by Parent A.

Example 3. University A, an eligible educational institution, offers reduced tuition charges to its employees and their dependent children. F is an employee of University A. F's dependent child, G, enrolls in a graduate-level course at University A. Section 117(d) does not apply, because it is limited to tuition reductions provided for education below the graduate level. Therefore, the amount of the tuition reduction received by G is treated as additional compensation from University A to F and is included in F's gross income. For purposes of claiming a Lifetime Learning Credit, F is treated as receiving payment of an amount equal to the tuition reduction from University A and, in turn, paying such amount to University A on behalf of F's child, G.

(c) *Adjustment to qualified tuition and related expenses for certain excludable educational assistance*—(1) *In general.* In determining the amount of an education tax credit, qualified tuition and related expenses for any academic period must be reduced by the amount of any tax-free educational assistance allocable to such period. For this purpose, *tax-free educational assistance* means—

(i) A qualified scholarship that is excludable from income under section 117;

(ii) A veterans' or member of the armed forces' educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code;

(iii) Employer-provided educational assistance that is excludable from income under section 127; or

(iv) Any other educational assistance that is excludable from gross income (other than as a gift, bequest, devise, or inheritance within the meaning of section 102(a)).

(2) *No adjustment for excludable educational assistance attributable to expenses paid in a prior year.* A reduction is not required under paragraph (c)(1) of this section if the amount of excludable educational assistance received during the taxable year is treated as a refund of qualified tuition and related expenses paid in a prior taxable year. See paragraph (f)(5) of this section.

(3) *Scholarships and fellowship grants.* For purposes of paragraph (c)(1)(i) of this section, a scholarship or fellowship grant is treated as a qualified scholarship excludable under section 117 except to the extent—

(i) The scholarship or fellowship grant (or any portion thereof) may be applied, by its terms, to expenses other than qualified tuition and related expenses within the meaning of section 117(b)(2) (such as room and board) and the student reports the grant (or the appropriate portion thereof) as income on the student's federal income tax return if the student is required to file a return; or

(ii) The scholarship or fellowship grant (or any portion thereof) must be applied, by its terms, to expenses other than qualified tuition and related expenses within the meaning of section 117(b)(2) (such as room and board) and the student reports the grant (or the appropriate portion thereof) as income on the student's federal income tax return if the student is required to file a return.

(4) *Examples.* The following examples illustrate the rules of this paragraph (c). In each example, assume that all the requirements to claim an education tax credit are met. The examples are as follows:

Example 1. University X charges Student A, who lives on University X's campus, $3,000 for tuition and $5,000 for room and board. University X awards Student A a $2,000 scholarship. The terms of the scholarship permit it to be used to pay any of a student's costs of attendance at University X, including tuition, room and board, and other incidental expenses. University X applies the $2,000 scholarship against Student A's $8,000 total bill, and Student A pays the $6,000 balance of her bill from University X with a combination of savings and amounts she earns from a summer job. University X does not require A to pay any additional fees beyond the $3,000 in tuition in order to enroll in or attend classes. Student A does not report any portion of the scholarship as income on her federal income tax return. Since Student A does not report the scholarship as income, the scholarship is treated under paragraph (c)(3) of this section as a qualified scholarship that is excludable under section 117. Therefore, for purposes of calculating an education tax credit, Student A is treated as having paid only $1,000 ($3,000 tuition - $2,000 scholarship) in qualified tuition and related expenses to University X.

Example 2. The facts are the same as in *Example 1*, except that Student A reports the entire scholarship as income on the student's federal income tax return. Since the full amount of the scholarship may be applied to expenses other than qualified expenses (room and board) and Student A reports the scholarship as income, the exception in paragraph (c)(3) of this section applies and the scholarship is not treated as a qualified scholarship excludable under section 117. Therefore, for purposes of calculating an education tax credit, Student A is treated as having paid $3,000 of qualified tuition and related expenses to University X.

Example 3. The facts are the same as in *Example 1*, except that the terms of the scholarship require it to be used to pay tuition. Under paragraph (c)(3) of this section, the scholarship is treated as a qualified scholarship excludable under section 117. Therefore, for purposes of calculating an education tax credit, Student A is treated as having paid only $1,000 ($3,000 tuition - $2,000 scholarship) in qualified tuition and related expenses to University X.

Example 4. The facts are the same as in *Example 1*, except that the terms of the scholarship require it to be used to pay tuition or room and board charged by University X, and the scholarship amount is $6,000. Under the terms of the scholarship, Student A may allocate the scholarship between tuition and room and board in any manner. However, because room and board totals $5,000, that is the maximum amount that can be applied under the terms of the scholarship to expenses other than qualified expenses and at least $1,000 of the scholarship must be applied to tuition. Therefore, the maximum amount of the exception under paragraph (c)(3) of this section is $5,000 and at least $1,000 is treated as a qualified scholarship excludable under section 117 ($6,000 scholarship - $5,000 room and board). If Student A reports $5,000 of the scholarship as income on the student's federal income tax return, then Student A will be treated as having paid $2,000 ($3,000 tuition - $1,000 qualified scholarship excludable under section 117) in qualified tuition and related expenses to University X.

Example 5. The facts are the same as in *Example 1*, except that in addition to the scholarship that University X awards to Student A, University X also provides Student A with an education loan and pays Student A for working in a work/study job in the campus dining hall. The loan is not excludable educational assistance within the meaning of paragraph (c) of this section. In addition, wages paid to a student who is performing services for the payor are neither a qualified scholarship nor otherwise excludable from gross income. Therefore, Student A is not required to reduce her qualified tuition and related expenses by the amounts she receives from the student loan or as wages from her work/study job.

Example 6. In 1999, Student B pays University Y $1,000 in tuition for the 1999 Spring semester. University Y does not require Student B to pay any additional fees beyond the $1,000 in tuition in order to enroll in classes. Student B is an employee of Company Z. At the end of the academic period and during the same taxable year that Student B paid tuition to University Y, Student B provides Company Z with proof that he has satisfactorily completed his courses at University Y. Pursuant to an educational assistance program described in section 127(b), Company Z reimburses Student B for all of the tuition paid to University Y. Because the reimbursement from Company Z is employer-provided educational assistance that is excludable from Student B's gross income under section 127, the reimbursement reduces Student B's qualified tuition and related expenses. Therefore, for purposes of calculating an education tax credit, Student B is treated as having paid no qualified tuition and related expenses to University Y during 1999.

Example 7. The facts are the same as in *Example 6* except that the reimbursement from Company Z is not pursuant to an educational assistance program described in section 127(b), is not otherwise excludable from Student B's gross income, and is taxed as additional compensation to Student B. Because the reimbursement is not excludable educational assistance within the meaning of paragraph (c)(1) of this section, Student B is not required to reduce his qualified tuition and related expenses by the $1,000 reimbursement he received from his employer. Therefore, for purposes of calculating an education tax credit, Student B is treated as paying $1,000 in qualified tuition and related expenses to University Y during 1999.

(d) *No double benefit.* Qualified tuition and related expenses do not include any expense for which a deduction is allowed under section 162, section 222, or any other provision of chapter 1 of the Internal Revenue Code.

(e) *Timing rules*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, an education tax credit is allowed only for payments of qualified tuition and related expenses for an academic period beginning in the same taxable year as the year the payment is made. Except for certain individuals who do not use the cash receipts and disbursements method of accounting, qualified tuition and related expenses are treated as paid in the year in which the expenses are actually paid. See § 1.461–1(a)(1).

(2) *Prepayment rule*—(i) *In general.* If qualified tuition and related expenses are paid during one taxable year for an academic period that begins during the first three months of the taxpayer's next taxable year (*i.e.*, in January, February, or March of the next taxable year for calendar year taxpayers), an education tax credit is allowed with respect to the qualified tuition and related expenses only in the taxable year in which the expenses are paid.

(ii) *Example.* The following example illustrates the rule of this paragraph (e)(2). In the example, assume that all the re-

quirements to claim an education tax credit are met. The example is as follows:

Example. In December 1998, Taxpayer A, a calendar year taxpayer, pays College Z $1,000 in qualified tuition and related expenses to attend classes during the 1999 Spring semester, which begins in January 1999. Taxpayer A may claim an education tax credit only in 1998 for payments made in 1998 for the 1999 Spring semester.

(3) *Expenses paid with loan proceeds.* An education tax credit may be claimed for qualified tuition and related expenses paid with the proceeds of a loan only in the taxable year in which the expenses are paid, and may not be claimed in the taxable year in which the loan is repaid. Loan proceeds disbursed directly to an eligible educational institution will be treated as paid on the date the institution credits the proceeds to the student's account. For example, in the case of any loan issued or guaranteed as part of a federal student loan program under Title IV of the Higher Education Act of 1965, loan proceeds will be treated as paid on the date of disbursement (as defined in 34 CFR 668.164(a), revised as of July 1, 2002) by the eligible educational institution. If a taxpayer does not know the date the institution credits the student's account, the taxpayer must treat the qualified tuition and related expenses as paid on the last date for payment prescribed by the institution.

(4) *Expenses paid through third party installment payment plans*—(i) *In general.* A taxpayer, an eligible educational institution, and a third party installment payment company may enter into an agreement in which the company agrees to collect installment payments of qualified tuition and related expenses from the taxpayer and to remit the installment payments to the institution. If the third party installment payment company is the taxpayer's agent for purposes of paying qualified tuition and related expenses to the eligible educational institution, the taxpayer is treated as paying the qualified expenses on the date the company pays the institution. However, if the third party installment payment company is the eligible educational institution's agent for purposes of collecting payments of qualified tuition and related expenses from the taxpayer, the taxpayer is treated as paying the qualified expenses on the date the taxpayer pays the company.

(ii) *Example.* The following example illustrates the rule of this paragraph (e)(4). The example is as follows:

Example. Student A, Company B, and College C enter into a written agreement in which Student A agrees to pay the tuition required to attend College C in 10 equal monthly installments to Company B. Under the written agreement, Student A is not relieved of her obligation to pay College C until Company B remits the payments to College C. Under the written agreement, Company B agrees to disburse the monthly installment payments to College C within 30 days of receipt. Because Company B acts as Student A's agent for purposes of paying qualified expenses to College C, Student A is treated as paying qualified expenses on the date Company B disburses payments to College C.

(f) *Refund of qualified tuition and related expenses*—(1) *Payment and refund of qualified tuition and related expenses in the same taxable year.* With respect to any student, the amount of qualified tuition and related expenses for a taxable year is calculated by adding all qualified tuition and related expenses paid for the taxable year, and subtracting any refund of such expenses received from the eligible educational institution during the same taxable year (including refunds of loan proceeds described in paragraph (f)(4) of this section).

(2) *Payment of qualified tuition and related expenses in one taxable year and refund in subsequent taxable year before return filed for prior taxable year.* If, in a taxable year, a taxpayer or someone other than the taxpayer receives a refund (including refunds of loan proceeds described in paragraph (f)(4) of this section) of qualified tuition and related expenses paid on behalf of a student in a prior taxable year and the refund is received before the taxpayer files a federal income tax return for the prior taxable year, the amount of the qualified tuition and related expenses for the prior taxable year is reduced by the amount of the refund.

(3) *Payment of qualified tuition and related expenses in one taxable year and refund in subsequent taxable year*—(i) *In general.* If, in a taxable year (refund year), a taxpayer or someone other than the taxpayer receives a refund (including refunds of loan proceeds described in paragraph (f)(4) of this section) of qualified tuition and related expenses paid on behalf of a student for which the taxpayer claimed an education tax credit in a prior taxable year, the tax imposed by chapter 1 of the Internal Revenue Code for the refund year is increased by the recapture amount.

(ii) *Recapture amount.* The recapture amount is the difference in tax liability for the prior taxable year (taking into account any redetermination of such tax liability by audit or amended return) that results when the tax liability for the prior year is calculated using the taxpayer's redetermined credit. The redetermined credit is computed by reducing the amount of the qualified tuition and related expenses taken into account in determining any credit claimed in the prior taxable year by the amount of the refund of the qualified tuition and related expenses (redetermined qualified expenses), and computing the allowable credit using the redetermined qualified expenses and the relevant facts and circumstances of the prior taxable year, such as modified adjusted gross income (redetermined credit).

(4) *Refund of loan proceeds treated as refund of qualified tuition and related expenses.* If loan proceeds used to pay qualified tuition and related expenses (as described in paragraph (e)(3) of this section) during a taxable year are refunded by an eligible educational institution to a lender on behalf of the borrower, the refund is treated as a refund of qualified tuition and related expenses for purposes of paragraphs (f)(1), (2), and (3) of this section.

(5) *Excludable educational assistance received in a subsequent taxable year treated as a refund.* If, in a taxable year, a taxpayer or someone other than the taxpayer receives any excludable educational assistance (described in paragraph (c)(1) of this section) for the qualified tuition and related expenses paid on behalf of a student during a prior taxable year (or attributable to enrollment at an eligible educational institution during a prior taxable year), the educational assistance is treated as a refund of qualified tuition and related expenses for purposes of paragraphs (f)(2) and (3) of this section. If the excludable educational assistance is received before the taxpayer files a federal income tax return for the prior taxable year, the amount of the qualified tuition and related expenses for the prior taxable year is reduced by the amount of the excludable educational assistance as provided in paragraph (f)(2) of this section. If the excludable educational assistance is received after the taxpayer has filed a federal income tax return for the prior taxable year, any education tax credit claimed for the prior taxable year is subject to recapture as provided in paragraph (f)(3) of this section.

(6) *Examples.* The following examples illustrate the rules of this paragraph (f). In

each example, assume that all the requirements to claim an education tax credit are met. The examples are as follows:

Example 1. In January 1998, Student A, a full-time freshman at University X, pays $2,000 for qualified tuition and related expenses for a 16-hour work load for the 1998 Spring semester. Prior to beginning classes, Student A withdraws from 6 course hours. On February 15, 1998, Student A receives a $750 refund from University X. In September 1998, Student A pays University X $1,000 to enroll half-time for the 1998 Fall semester. Prior to beginning classes, Student A withdraws from a 2-hour course, and she receives a $250 refund in October 1998. Student A computes the amount of qualified tuition and related expenses she may claim for 1998 by:

(i) Adding all qualified expenses paid during the taxable year ($2,000 + 1,000 = $3,000);

(ii) Adding all refunds of qualified tuition and related expenses received during the taxable year ($750 + $250 = $1,000); and, then

(iii) Subtracting paragraph (ii) of this *Example 1* from paragraph (i) of this *Example 1* ($3,000 - $1,000 = $2,000). Therefore, Student A's qualified tuition and related expenses for 1998 are $2,000.

Example 2. (i) In December 1998, Student B, a senior at College Y, pays $2,000 for qualified tuition and related expenses for a 16-hour work load for the 1999 Spring semester. Prior to beginning classes, Student B withdraws from a 4-hour course. On January 15, 1999, Student B files her 1998 income tax return and claims a $400 Lifetime Learning Credit for the $2,000 qualified expenses paid in 1998, which reduces her tax liability for 1998 by $400. On February 15, 1999, Student B receives a $500 refund from College Y.

(ii) Student B calculates the increase in tax for 1999 by—

(A) Calculating the redetermined qualified expenses for 1998 ($2,000 - $500 = $1,500);

(B) Calculating the redetermined credit for the redetermined qualified expenses ($1,500 x .20 = $300); and

(C) Calculating the difference in tax liability for 1998 resulting from the redetermined credit. Because Student B's tax liability for 1998 was reduced by the full amount of the $400 education tax credit claimed on her 1998 income tax return, the difference in tax liability can be determined by subtracting the redetermined credit from the credit claimed in 1998 ($400 - $300 = $100).

(iii) Therefore, Student B must increase the tax on her 1999 federal income tax return by $100.

Example 3. In September 1998, Student C pays College Z $1,200 in qualified tuition and related expenses to attend evening classes during the 1998 Fall semester. Student C is an employee of Company R. On January 15, 1999, Student C files a federal income tax return for 1998 claiming a Lifetime Learning Credit of $240 (.20 x $1,200), which reduces Student C's tax liability for 1998 by $240. Pursuant to an educational assistance program described in section 127(b), Company R reimburses Student C in February 1999 for the $1,200 of qualified tuition and related expenses paid by Student C in 1998. The $240 education tax credit claimed by Student C for 1998 is subject to recapture. Because Student C paid no net qualified tuition and related expenses for 1998, the redetermined credit for 1998 is zero. Student C must increase the amount of Student C's 1999 tax by the recapture amount, which is $240 (the difference in tax liability for 1998 resulting from the redetermined credit for 1998 ($0)). Because the $1,200 reimbursement relates to expenses for which the taxpayer claimed an education tax credit in a prior year, the reimbursement does not reduce the amount of any qualified tuition and related expenses that Student C paid in 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In section 602.101, paragraph (b) is revised by adding the following entry in numerical order to the table:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.25A–1	1545–1630
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 13, 2002.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 24, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 26, 2002, 67 F.R. 78687)

Section 45D.—New Markets Tax Credit

26 CFR 1.45D–1T: New markets tax credit.

New markets tax credit. This ruling holds that, for purposes of determining the new markets tax credit under the facts of the ruling, the amount of the qualified equity investment made by a limited liability company (LLC) classified as a partnership includes cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity.

Rev. Rul. 2003–20

ISSUE

For purposes of determining the new markets tax credit allowable under § 45D of the Internal Revenue Code, does the amount of the qualified equity investment made by a limited liability company (LLC) classified as a partnership include cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity?

FACTS

In Year 1, *CDE*, a qualified community development entity under § 45D(c), receives a new markets tax credit allocation of $2,000*x* from the Secretary of the Treasury. In Year 2, *X*, a widely-held C corporation, contributes $792*x* for a 99-percent member interest in *LLC*, a limited liability company that is classified as a partnership for federal tax purposes. *Y*, a widely-held C corporation, contributes $8*x* for a 1-percent managing member interest in *LLC*. *LLC* borrows $1,200*x* from *Bank*, an unrelated third party. *LLC* contributes $2,000*x* for an equity interest in *CDE*, which is a limited liability company clas-

sified as a partnership for federal tax purposes. *CDE* designates *LLC*'s equity investment in *CDE* as a qualified equity investment under § 45D(b)(1)(C).

The $1,200*x* loan from *Bank* is a nonrecourse liability that is characterized as indebtedness of *LLC* for federal tax purposes. The loan is secured only by *LLC*'s interest in *CDE*. The loan is not secured by any assets of *CDE*. The full amount of the loan is repayable at the end of Year 9. The loan is not convertible into an equity interest in *LLC*.

On April 1 of Year 2, *CDE* lends the $2,000*x* to a qualified active low-income community business, as defined in § 45D(d)(2)(A). This $2,000*x* loan is repayable in full at the end of Year 9. Interest payments received by *CDE* from the qualified active low-income community business are distributed to *LLC*. *X* and *Y* retain their membership interests in *LLC*, and *LLC* retains its $2,000*x* equity investment in *CDE*, until the end of Year 9. The entire $2,000*x* loan by *CDE* remains outstanding, and the borrower continues to qualify as a qualified active low-income community business, until the end of Year 9.

LLC claims its qualified equity investment in *CDE* is $2,000*x* on each credit allowance date and allocates the new markets tax credit with respect to this amount to *X* and *Y* in accordance with § 704(b).

LAW

Section 45D(a)(1) provides that for purposes of § 38, in the case of a taxpayer who holds a qualified equity investment on a credit allowance date (as defined in § 45D(a)(3)) of the investment which occurs during the taxable year, the new markets tax credit determined under § 45D for the taxable year is an amount equal to the applicable percentage (as defined in § 45D(a)(2)) of the amount paid to the qualified community development entity for the investment at its original issue. Section 7701(a)(14) defines the term "taxpayer" to mean any person subject to any internal revenue tax. Section 7701(a)(1) provides that the term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Section 45D(b)(1) defines the term "qualified equity investment" as any equity investment in a qualified community development entity if (A) the investment is acquired by the taxpayer at its original issue (directly or through an underwriter) solely in exchange for cash, (B) substantially all of the cash is used by the qualified community development entity to make qualified low-income community investments, and (C) the investment is designated for purposes of § 45D by the qualified community development entity.

Section 45D(b)(2) provides that the maximum amount of equity investments issued by a qualified community development entity which may be designated under § 45D(b)(1)(C) by the entity shall not exceed the portion of the limitation amount allocated under § 45D(f) to the entity.

Section 45D(b)(6) defines the term "equity investment" as (A) any stock (other than nonqualified preferred stock as defined in § 351(g)(2)) in an entity that is a corporation, and (B) any capital interest in an entity that is a partnership.

Section 45D(c)(1) defines the term "qualified community development entity" as any domestic corporation or partnership if (A) the primary mission of the entity is serving, or providing investment capital for, low-income communities or low-income persons, (B) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity, and (C) the entity is certified by the Secretary for purposes of § 45D as being a qualified community development entity.

Section 45D(d)(1) defines the term "qualified low-income community investment" as (A) any capital or equity investment in, or loan to, any qualified active low-income community business, (B) the purchase from another qualified community development entity of any loan made by the entity which is a qualified low-income community investment, (C) financial counseling and other services specified in regulations prescribed by the Secretary to businesses located in, and residents of, low-income communities, and (D) any equity investment in, or loan to, any qualified community development entity. Section 45D(d)(2)(A) defines the term "qualified active low-income community business" as any corporation or partnership that satisfies the requirements of § 45D(d)(2)(A)(i) through (v).

ANALYSIS

Section 45D(b)(1)(A) requires that a qualified equity investment be acquired by the taxpayer solely in exchange for cash. Section 45D does not prohibit a taxpayer (including any taxpayer who is a person as defined under § 7701(a)(1)) from using cash derived from a borrowing, including nonrecourse borrowing, to make a qualified equity investment in a qualified community development entity. The facts of this revenue ruling state that the loan from *Bank* is characterized as indebtedness of *LLC* for federal tax purposes. The loan proceeds and the contributions by *X* and *Y* to *LLC* are used by *LLC* to make an equity investment of $2,000*x* in *CDE*. The requirements of § 45D(b)(1)(A) are satisfied because *LLC* acquires its investment in *CDE* at its original issue solely in exchange for cash. The requirements of § 45D(b)(1)(B) are satisfied because *CDE* uses the entire equity investment of $2,000*x* to make a qualified low-income community investment. The requirements of § 45D(b)(1)(C) are satisfied because *CDE* designates the equity investment of $2,000*x* for purposes of § 45D. Accordingly, *LLC* is treated as having made a qualified equity investment of $2,000*x* in *CDE* when *LLC* acquires its equity interest in *CDE*. *LLC* may claim a new markets tax credit on each credit allowance date in an amount determined under § 45D that is equal to the applicable percentage of the $2,000*x* qualified equity investment in *CDE*. *LLC* may allocate to *X* and *Y* the amount of the new markets tax credit that *LLC* claims with respect to the $2,000*x* qualified equity investment. This allocation must be made in accordance with § 704(b) (which provides rules regarding a partnership's allocation of income, gain, loss, deduction, or credit (or item thereof) among the partners).

HOLDING

Under the facts of this revenue ruling, for purposes of determining the new markets tax credit allowable under § 45D, the amount of the qualified equity investment made by an LLC classified as a partnership includes cash from a nonrecourse loan to the LLC that the LLC invests as equity in a qualified community development entity.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael J. Goldman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Goldman at (202) 622–3080. For information regarding issues under § 45D, contact Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries) at (202) 622–3040. These are not toll-free calls.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355–3: Active conduct of a trade or business.

Section 355. This ruling discusses whether the acquisition by D, a brand X automobile dealer, of a brand Y automobile dealership constitutes an expansion of the brand X business or an acquisition of a new or different business under section 1.355–3(b)(3)(ii) of the regulations. Rev. Rul. 57–190 obsoleted.

Rev. Rul. 2003–18

ISSUE

Whether the acquisition by a dealer engaged in the sale and service of brand X automobiles of a franchise to sell and service brand Y automobiles and the assets to operate the franchise constitutes an expansion of the brand X business rather than the acquisition of a new or different business under § 1.355–3(b)(3)(ii) of the Income Tax Regulations.

FACTS

Corporation D has been engaged under a dealer franchise in the sale and service of brand X automobiles since Year 1. For over five years before Year 8, these operations had been carried on in two buildings (L and M) within the same city. In Year 8, D acquired a franchise for the sale and service of brand Y automobiles and purchased the inventories, equipment, and leasehold of a former brand Y automobile dealer who operated in a building adjoining D's building L. Shortly thereafter, D relocated the inventory of brand X automobiles from building L to building M. Thereafter, D used building M exclusively for the sale and service of brand X automobiles and used building L and the adjoining leasehold exclusively for the sale and service of brand Y automobiles.

In Year 10, D transferred all of the assets, including building M, and liabilities of the brand X automobile dealership to a new corporation, C, in exchange for the stock of C, and distributed the stock of C *pro rata* to its shareholders.

LAW AND ANALYSIS

Section 355(a) of the Internal Revenue Code provides that a corporation may distribute stock and securities in a controlled corporation to its shareholders and security holders in a transaction that will not cause the distributees to recognize gain or loss, provided that, among other requirements, (i) each of the distributing corporation and controlled corporation is engaged, immediately after the distribution, in the active conduct of a trade or business, (ii) each trade or business has been actively conducted throughout the five-year period ending on the date of the distribution, and (iii) neither trade or business has been acquired in a transaction in which gain or loss was recognized, in whole or in part, within the five-year period. Sections 355(b)(1)(A), 355(b)(2)(B), and 355(b)(2)(C).

In determining whether an active trade or business has been conducted by a corporation throughout the five-year period preceding the distribution, the fact that a trade or business underwent change during the five-year period (for example, by the addition of new or the dropping of old products, changes in production capacity, and the like) shall be disregarded, provided that the changes are not of such a character as to constitute the acquisition of a new or different business. Section 1.355–3(b)(3)(ii). In particular, if a corporation engaged in the active conduct of one trade or business during that five-year period purchased, created, or otherwise acquired another trade or business in the same line of business, then the acquisition of that other business is ordinarily treated as an expansion of the original business, all of which is treated as having been actively conducted during that five-year period, unless that purchase, creation, or other acquisition effects a change of such character as to constitute the acquisition of a new or different business. *Id.*

In Example (8) of § 1.355–3(c), corporation X had owned and operated hardware stores in several states for four years before purchasing the assets of a hardware store in State M where X had not previously conducted business. Two years after the purchase, X transferred the State M store and related business assets to new subsidiary Y and distributed the Y stock to X's shareholders. Citing § 1.355–3(b)(3)(i) and (ii), the example concludes that X and Y both satisfy the requirements of section 355(b).

In this case, because (i) the product of the brand X automobile dealership is similar to the product of the brand Y automobile dealership, (ii) the business activities associated with the operation of the brand X automobile dealership (*i.e.*, sales and service) are the same as the business activities associated with the operation of the brand Y automobile dealership, and (iii) the operation of the brand Y automobile dealership involves the use of the experience and know-how that D developed in the operation of the brand X automobile dealership, the brand Y automobile dealership is in the same line of business as the brand X dealership and its acquisition does not constitute the acquisition of a new or different business under § 1.355–3(b)(3)(ii). Instead, it constitutes an expansion of D's existing business. Accordingly, each of D and C is engaged in the active conduct of a five-year active trade or business immediately after the distribution. *See* § 1.355–3(c), Example (8).

HOLDING

The acquisition by D, a brand X automobile dealer, of the brand Y automobile dealership constitutes an expansion of the brand X business and does not constitute the acquisition of a new or different business under § 1.355–3(b)(3)(ii).

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 57–190, 1957–1 C.B. 121, is obsoleted as of January 5, 1989.

DRAFTING INFORMATION

The principal author of this revenue ruling is Lisa S. Dobson of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue

ruling, contact Ms. Dobson at (202) 622–7790 (not a toll-free call).

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

Insurance demutualization. This ruling provides guidance as to the tax consequences that occur when, as described in the facts set forth in this ruling, a mutual insurance company converts to a stock insurance company.

Rev. Rul. 2003–19

ISSUE

What are the tax consequences when, as described in the facts below, a mutual insurance company converts to a stock insurance company?

FACTS

In each of the situations described below, Mutual Company is a State Y mutual insurance company that offers life insurance and annuity products. Members of Mutual Company have both membership interests in Mutual Company and contractual rights under either insurance policies or annuity contracts.

A membership interest in Mutual Company arises from the purchase of a life insurance or an annuity contract and is inextricably tied to the contract from the time of purchase. A membership interest in Mutual Company entitles the member to vote for the board of directors and to receive assets or other consideration in the event of the demutualization, dissolution, or liquidation of Mutual Company. The rights inherent in each membership interest are created by operation of State Y law solely as a result of the policyholder's acquisition of the underlying contract from Mutual Company and cannot be transferred separately from that contract. Further, if the contract is surrendered by the policyholder or, in the event the contract is terminated by payment of benefits to the contract beneficiary, these membership interests cease to exist, having no continuing value.

Mutual Holding Company is a mutual insurance holding company. A membership interest in Mutual Holding Company arises from the purchase of a life insurance or an annuity contract from a wholly owned subsidiary of Mutual Holding Company and is inextricably tied to the contract from the time of purchase. A membership interest in Mutual Holding Company entitles the member to vote for the board of directors of Mutual Holding Company and to receive assets or other consideration in the event of the demutualization, dissolution, or liquidation of Mutual Holding Company. The rights inherent in each membership interest are created by operation of State Y law solely as a result of the policyholder's acquisition of the underlying contract from a wholly owned subsidiary of Mutual Holding Company and cannot be transferred separately from that contract. Further, if the contract is surrendered by the policyholder or, in the event the contract is terminated by payment of benefits to the contract beneficiary, these membership interests cease to exist, having no continuing value.

Stock Holding Company is a stock company the articles of incorporation and bylaws of which authorize the issuance of capital stock.

Each transaction described below is undertaken for a valid business purpose.

Situation 1. Pursuant to a plan to convert Mutual Company from a mutual insurance company to a stock insurance company, Mutual Company amends and restates its articles of incorporation and bylaws to authorize the issuance of capital stock and changes its name to Stock Company. Pursuant to State Y law, members of Mutual Company surrender their membership interests in Mutual Company to Stock Company in exchange for all of Stock Company's voting common stock. However, those persons holding Mutual Company membership interests under contracts covered by § 403(b) or § 408(b) of the Income Tax Code receive policy credits in exchange for those interests.

Situation 2. Pursuant to State Y law and pursuant to an integrated plan to convert Mutual Company from a mutual insurance company to a stock insurance company and create a holding company structure, the following events occur. Mutual Company incorporates Mutual Holding Company as a mutual insurance holding company, which, in turn, incorporates Stock Holding Company. Thereafter, the following events occur substantially contemporaneously: Mutual Company amends and restates its articles of incorporation and bylaws to authorize the issuance of capital stock and changes its name to Stock Company; Mutual Company's members receive Mutual Holding Company membership interests in place of their former Mutual Company membership interests; Stock Company issues all of its stock directly to Mutual Holding Company; and Mutual Holding Company transfers all of its Stock Company stock to Stock Holding Company in exchange for voting stock of Stock Holding Company.

After these transactions, the former members of Mutual Company are in control (within the meaning of § 368(c)) of Mutual Holding Company. Mutual Holding Company plans to maintain control (within the meaning of § 368(c)) of Stock Holding Company after these transactions, and Stock Holding Company plans to maintain control (within the meaning of § 368(c)) of Stock Company after these transactions.

Situation 3. Mutual Holding Company owns all of the stock of Stock Holding Company, which owns all of the stock of Stock Company 1, a stock insurance company that offers life insurance and annuity products. Pursuant to State Y law and pursuant to an integrated plan to acquire Mutual Company, the following events occur substantially contemporaneously: Mutual Company amends and restates its articles of incorporation and by-laws to authorize the issuance of capital stock and changes its name to Stock Company 2; Mutual Company's members receive Mutual Holding Company membership interests in place of their former Mutual Company membership interests; Stock Company 2 issues all of its stock directly to Mutual Holding Company; and Mutual Holding Company transfers all of its Stock Company 2 stock to Stock Holding Company in exchange for voting stock of Stock Holding Company.

After these transactions, the former members of Mutual Company are not in control (within the meaning of § 368(c)) of Mutual Holding Company. Mutual Holding Company plans to maintain control (within the meaning of § 368(c)) of Stock

Holding Company after these transactions, and Stock Holding Company plans to maintain control (within the meaning of § 368(c)) of Stock Company 2 after these transactions.

In Situations 1 and 2, under State Y law, Stock Company's corporate existence as a stock insurance company is a continuation of Mutual Company's corporate existence as a mutual insurance company. In Situation 3, under State Y law, Stock Company 2's corporate existence as a stock insurance company is a continuation of Mutual Company's corporate existence as a mutual insurance company. In Situations 1, 2, and 3, the conversion of Mutual Company from a mutual insurance company to a stock insurance company does not affect any of its policies in force as of the time of the conversion nor the policyholders' rights to receive any policy dividends thereunder. Moreover, after the transactions, Stock Company has no plan or intention to terminate or dispose of the policies in force as of the time of the conversion other than pursuant to their own terms. After the conversions, Stock Company and Stock Company 2 continue to offer life insurance and annuity products.

LAW

Section 351(a) provides that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation.

Section 368(a)(1)(B) provides that the term reorganization means the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).

Section 368(a)(1)(E) provides that the term reorganization includes a recapitalization. In *Helvering v. Southwest Consol. Corp.*, 315 U.S. 194, 202 (1942), the Supreme Court defined a recapitalization as a "reshuffling of a capital structure within the framework of an existing corporation."

Section 368(a)(1)(F) provides that the term reorganization means a mere change in identity, form, or place of organization of one corporation, however effected.

Section 354(a) provides that, in general, no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Section 368(a)(2)(C) states, in relevant part, that a transaction otherwise qualifying under § 368(a)(1)(B) will not be disqualified by reason of the fact that part or all of the stock that was acquired in the transaction is transferred to a corporation controlled by the corporation acquiring such stock.

Section 1.368–2(k)(1) of the Income Tax Regulations restates the general rule of § 368(a)(2)(C) but permits the assets or stock acquired in certain types of reorganizations, including reorganizations under section 368(a)(1)(B), to be successively transferred to one or more corporations controlled (as defined in § 368(c)) in each transfer by the transferor corporation without disqualifying the reorganization.

Generally, to qualify as a reorganization under § 368(a)(1), a transaction must satisfy the continuity of business enterprise (COBE) requirement. Section 1.368–1(d)(1) provides that COBE requires the issuing corporation (generally the acquiring corporation) in a potential reorganization to either continue the target corporation's historic business or use a significant portion of the target's historic business assets in a business. Pursuant to § 1.368–1(d)(4)(i), the issuing corporation is treated as holding all of the businesses and assets of all members of its qualified group. Section 1.368–1(d)(4)(ii) defines a qualified group as one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of § 368(c) in at least one other corporation, and stock meeting the requirements of § 368(c) in each of the corporations (except the issuing corporation) is owned directly by one of the other corporations. Continuity of business enterprise is not required for a recapitalization to qualify as a reorganization under § 368(a)(1)(E). *See* Rev. Rul. 82–34, 1982–1 C.B. 59.

Generally, to qualify as a reorganization under § 368(a)(1), a transaction must satisfy the continuity of interest requirement. Section 1.368–1(e)(1)(i) provides that continuity of interest requires that in substance a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. All facts and circumstances must be considered in determining whether, in substance, a proprietary interest in the target corporation is preserved. Continuity of interest is not a requirement for reorganizations under § 368(a)(1)(E). *See* Rev. Rul. 77–415, 1977–2 C.B. 311.

In *Paulsen v. Commissioner*, 469 U.S. 131 (1985), a state-chartered stock savings and loan association merged into a federally-chartered non-stock mutual savings and loan association. The stockholders exchanged all of their stock in the state-chartered stock savings and loan association for passbook savings accounts and certificates of deposit in the federally-chartered non-stock mutual savings and loan association. The Supreme Court determined that the passbooks and certificates of deposit in the federally-chartered non-stock mutual savings and loan association had a predominantly cash-equivalent component and an insubstantial equity component. Because the passbooks and certificates of deposit essentially represented cash with an insubstantial equity component, the Court held that the transaction did not satisfy the continuity of interest requirement and, therefore, did not qualify as a tax-free reorganization.

In Rev. Rul. 69–3, 1969–1 C.B. 103, X, a mutual savings and loan association, merged into Y, another mutual savings and loan association. In the merger, Y issued to each share account holder of X a share account equal to the dollar amount evidenced by such holder's passbook. Because the share account holders of X received proprietary interests in Y that were equivalent to their equity interests in X before the exchange, the exchange was solely an equity-for-equity exchange that satisfied the continuity of interest requirement. Accordingly, the Service ruled that the transaction qualified as a tax-free reorganization under § 368(a)(1)(A).

Section 403(b)(1) provides, in general, that certain amounts contributed to an annuity contract that satisfies the requirements of § 403(b) are taxable to the distributee under § 72 in the year actually distributed. Similarly, § 408(d) provides, in general, that any amount paid or distributed out of an individual retirement plan is included in gross income by the payee or distributee, as the case may be, in the manner provided under § 72.

ANALYSIS

Situation 1. Because Stock Company is the same corporation as Mutual Company under State Y law, the conversion from a mutual insurance company to a stock insurance company is a reorganization under § 368(a)(1)(E) as well as a reorganization under § 368(a)(1)(F), and the exchange by members of their Mutual Company membership interests for stock in Stock Company is pursuant to that reorganization.

Those persons holding Mutual Company interests under contracts covered by § 403(b) or § 408(b) who receive only policy credits in the conversion are treated as receiving those policy credits in redemption of their Mutual Company interests. However, pursuant to §§ 403(b)(1) and 408(d), no amount credited to the account of a policyholder under a § 403(b) contract or under a § 408(b) contract is taxable until actually distributed to the policyholder or to a beneficiary under the contract in accordance with § 72.

Situation 2. As in Situation 1, because Stock Company is the same corporation as Mutual Company under State Y law, the conversion from a mutual insurance company to a stock insurance company is a reorganization under § 368(a)(1)(E) as well as a reorganization under § 368(a)(1)(F). This conclusion is not altered by the fact that there is a subsequent change in the direct ownership of the converted company. *See* § 1.368–1(e)(1); Rev. Rul. 96–29, 1996–1 C.B. 50; Rev. Rul. 77–415, 1977–2 C.B. 311.

Each of the membership interests in Mutual Company and Mutual Holding Company constitutes a proprietary interest in the entities that is treated as voting stock. *See* Rev. Rul. 69–3, 1969–1 C.B. 103. Because Mutual Holding Company acquires, in exchange solely for membership interests in Mutual Holding Company, either an interest equivalent to the stock of Stock Company or the actual stock of Stock Company, and, immediately after that acquisition, Mutual Holding Company controls Stock Company, that acquisition qualifies as a reorganization under § 368(a)(1)(B), provided that the continuity of business enterprise and continuity of interest requirements are satisfied. Because Stock Company continues to offer life insurance and annuity products after the transactions described herein, the continuity of business enterprise requirement is satisfied. *See* § 1.368–1(d)(1). In addition, the acquisition satisfies the continuity of interest requirement because, in the overall transaction, the Mutual Company members receive Mutual Holding Company membership interests in place of their former Mutual Company membership interests. *See* Rev. Rul. 69–3, 1969–1 C.B. 103; *cf. Paulsen v. Commissioner*, 469 U.S. 131 (1985). Thus, the acquisition qualifies as a reorganization within the meaning of § 368(a)(1)(B). Moreover, Mutual Holding Company's subsequent transfer of the Stock Company stock to Stock Holding Company does not prevent the acquisition from qualifying as a reorganization under § 368(a)(1)(B). *See* § 368(a)(2)(C); § 1.368–1(d)(4)(i); § 1.368–2(k).

For purposes of § 354, the former Mutual Company's members' exchange of their ownership interests for Mutual Holding Company membership interests is pursuant to that reorganization. That exchange also qualifies as a transfer described in § 351, even though Mutual Holding Company transfers all of its Stock Company stock to Stock Holding Company. *See* Rev. Rul. 77–449, 1977–2 C.B. 110.

Finally, because Stock Holding Company acquires in exchange solely for voting stock the stock of Stock Company and, immediately after that acquisition, Stock Holding Company controls Stock Company, that acquisition qualifies as a reorganization under § 368(a)(1)(B). For purposes of § 354, Mutual Holding Company's exchange of stock of Stock Company for stock of Stock Holding Company is pursuant to that reorganization. In addition, that exchange qualifies as a transfer described in § 351.

Situation 3. For the reasons described in the analysis of Situation 2, the conversion from Mutual Company to Stock Company 2 qualifies as a reorganization under § 368(a)(1)(E) as well as a reorganization under § 368(a)(1)(F). In addition, Mutual Holding Company's acquisition, in exchange solely for membership interests in Mutual Holding Company, of either an interest equivalent to the stock of Stock Company 2 or the actual stock of Stock Company 2 qualifies as a reorganization under § 368(a)(1)(B). For purposes of § 354, the former Mutual Company's members' exchange of their ownership interests for Mutual Holding Company membership interests is pursuant to that reorganization. Finally, Mutual Holding Company's transfer of its Stock Company 2 stock to Stock Holding Company qualifies as a reorganization within the meaning of § 368(a)(1)(B) and as a transfer described in § 351.

HOLDING

This revenue ruling describes the tax consequences that occur when, as described in the facts set forth in this ruling, a mutual insurance company converts to a stock insurance company. The same analysis with respect to subchapter C also would apply if Mutual Company had offered only property and casualty insurance products and not life insurance and annuity products.

The transactions described in Situations 1, 2, and 3 have no effect on the date each life insurance and annuity contract of Mutual Company was issued, entered into, purchased or came into existence for purposes of §§ 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(q), 72(s), 72(u), 72(v), 101(f), 264(a)(3), 264(a)(4), 264(f), 7702 and 7702A. Furthermore, the transactions do not require retesting or the starting of new test periods for contracts under §§ 264(d)(1), 7702(f)(7)(B) through (E) and 7702A (c)(3)(A).

The transactions described in Situations 1, 2, and 3 have no effect on each life insurance or annuity contract that is part of a qualified plan within the meaning of § 401(a) or that meets the requirements of § 403(b) or § 408(b) for purposes of §§ 72(e)(5), 401, 402, 403, 408 and 408A. These transactions do not result in a distribution in violation of § 403(b)(11) or otherwise disqualify a § 403(b) contract under § 403(b). Similarly, these transactions do not result in an actual or deemed distribution in violation of § 401(k)(2)(B) or otherwise disqualify a qualified cash or deferred arrangement within the meaning of § 401(k). These transactions do not con-

stitute, with respect to policies issued by Mutual Company and in force prior to the effective date of the reorganizations and that are tax-qualified under § 401(a) or meet the requirements of § 403(b) or § 408(b), a distribution from or a contribution to any of these policies, plans or arrangements for federal income tax purposes. Finally, the transactions described in Situations 1, 2, and 3 do not result in a distribution and, thus, do not result in: (a) any gross income to the employee or the beneficiary of a contract as a distribution from a qualified retirement plan under § 72, prior to an actual receipt of some amount therefrom by such employee or beneficiary; (b) any 10 percent additional tax under § 72(t) for premature distributions from a qualified retirement plan; (c) any 6 percent or 10 percent excise tax under §§ 4973 or 4979, respectively, for excess contributions to certain qualified retirement plans; or (d) a designated distribution under § 3405(e)(1)(A) that is subject to withholding under § 3405(b) or (c).

DRAFTING INFORMATION

The principal authors of this revenue ruling are Jeffrey B. Fienberg and Emidio J. Forlini, Jr., of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact either Mr. Fienberg or Mr. Forlini at (202) 622–7930 (not a toll-free call).

Section 645.—Certain Revocable Trusts Treated as Part of Estate

26 CFR 1.645–1: Election by certain revocable trusts to be treated as part of estate.

T.D. 9032

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Election to Treat Trust as Part of an Estate

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 645 relating to an election for certain revocable trusts to be treated and taxed as part of an estate. The final regulations provide the procedures and requirements for making the election, rules regarding the tax treatment of the trust and the estate while the election is in effect, and rules regarding the termination of the election. This document also contains final regulations clarifying the reporting rules for a trust, or portion of a trust, that is treated as owned by the grantor, or another person under the provisions of subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code, for the taxable year ending with the death of the grantor or other person.

DATES: *Effective Date:* These regulations are effective December 24, 2002.

Applicability Date: For dates of applicability of these regulations, see §§ 1.645–1(j), 1.671–4(i)(3), 1.6072–1(a)(2)(ii), 301.6109–1(a)(6).

FOR FURTHER INFORMATION CONTACT: Faith Colson, (202) 622–3060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1578. This final rule makes no substantive change in the previously approved collection of information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On December 18, 2000, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–106542–98, 2001–1 C.B. 473) in the **Federal Register** (65 FR 79015) under section 645 relating to an election for certain revocable trusts to be treated and taxed as part of an estate. This notice also contained proposed amendments to the regulations under section 671 relating to reporting rules for a trust, or portion of a trust, that is treated as owned by the grantor or another person under the provisions of subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code (Code), for the taxable year ending with the death of the grantor or other person. Written comments responding to the notice of proposed rulemaking were received. A public hearing on the notice of proposed rulemaking was scheduled for April 11, 2001, but was canceled when no one requested to speak at the hearing. After consideration of all comments, the proposed regulations, with certain changes in response to the comments, are adopted as final regulations by this Treasury decision.

Summary of Comments and Explanation of Revisions

A. *Comments and Changes to § 1.645–1(b): Definitions*

Under section 645, if both the executor (if any) of an estate and the trustee of a qualified revocable trust (QRT) elect the treatment provided in section 645, the trust shall be treated and taxed for income tax purposes as part of the estate (and not as a separate trust) during the election period. The proposed regulations define a QRT as any trust (or portion thereof) that on the date of death of the decedent was treated as owned by the decedent under section 676 by reason of a power held by the decedent (determined without regard to section 672(e)). In accordance with the legislative history accompanying section 645, the proposed regulations provide that a trust, in which the power is held solely by a nonadverse party, is not a QRT. See H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. at 711 (1997). In addition, the proposed regulations provide that a trust, in which the power was exercisable by the decedent only with the approval or consent of another person, is not a QRT.

Some commentators suggested that, if the decedent's power to revoke the trust was exercisable only with the approval or consent of a nonadverse party, the trust should qualify as a QRT. Many persons use revocable trusts as property management tools and, to protect the grantor from improvident decisions or undue influence, their trust agreements may provide that any revocation of the trust by the grantor will be effective only if consented to by a nonadverse party. The commentators noted that the prohibition described in the legislative history addresses trusts in which only a nonadverse party has a power to revoke.

In response to these comments, the final regulations provide that a trust that was treated as owned by the decedent under section 676 by reason of a power that was exercisable by the decedent with the consent or approval of a nonadverse party is a QRT. The final regulations also clarify that while a trust, in which the power to revoke is held only by the decedent's spouse and not by the decedent, is not a QRT, a trust, in which the power to revoke is exercisable by the decedent with the approval or consent of the decedent's spouse, is a QRT.

Clarification has also been requested regarding whether a trust qualifies as a QRT if the grantor's power to revoke the trust lapses prior to the grantor's death as a result of the grantor's incapacity. Some trust documents for revocable trusts provide that the trustee is to disregard the instructions of the grantor to revoke the trust if the grantor is incapacitated. The IRS and the Treasury Department believe that, if an agent or legal representative of the grantor can revoke the trust under state law during the grantor's incapacity, the trust will qualify as a QRT, even if the grantor is incapacitated on the date of the grantor's death.

The proposed regulations also provide that a QRT must be a domestic trust under section 7701(a)(30)(E) and that a section 645 election for a QRT must result in a domestic estate under section 7701(a)(30)(D). Several commentators suggested that the section 645 election should also be available in situations in which either the QRT or the related estate, or both, are foreign. According to the commentators, U.S. citizens living abroad frequently use revocable trusts to avoid jurisdictional disputes concerning the decedent's assets, as well as the cumbersome probate and forced heirship rules of several foreign countries. Many of the trusts will be foreign trusts upon the grantor's death and, if a section 645 election is permitted to be made, will become part of a foreign estate. The commentators questioned the authority for the domestic restriction provided in the proposed regulations given that the statute and the legislative history do not explicitly limit the applicability of a section 645 election to domestic trusts and domestic estates. Upon consideration of these comments, the requirements that a QRT be a domestic trust and that the election result in a domestic estate are removed from the final regulations. The IRS and the Treasury Department note, however, that a trust for which a section 645 election is made is treated as an estate for purposes of Subtitle A of the Code, but not for purposes of Subtitle F. Accordingly, information reporting under section 6048 will continue to apply with respect to a foreign trust even though a section 645 election has been made to allow the foreign trust to be taxed as part of an estate for purposes of Subtitle A of the Code.

The proposed regulations used the term personal representative to denote the fiduciary (or fiduciaries) of the decedent's estate. One commentator requested that the definition of personal representative in the proposed regulations be expanded to include a personal representative, as well as an executor and an administrator. To be consistent with the language of the statute, the final regulations use the term executor, instead of personal representative, to denote the fiduciary of the decedent's estate. With the exception of including a personal representative in the definition of an executor as requested by the comment, the definition of executor in the final regulations is generally the same as the definition of a personal representative in the proposed regulations. The definition of executor used in these final regulations, however, is not identical to the definition of an executor under section 2203 of the Code: under these final regulations, a person who has actual or constructive possession of property of the decedent is not an executor unless that person is also appointed, or qualified as an executor, administrator, or personal representative of the decedent's estate.

B. *Comments and Changes to § 1.645–1(c): The Election*

The section 645 election may be made whether or not an executor is appointed for the decedent's estate. Under the final regulations, if an executor is appointed for the decedent's estate, the executor and the trustee of the QRT make the section 645 election by filing a form provided by the IRS for the purpose of making the section 645 election (election form). If an executor is not appointed for the decedent's estate, the trustee makes the section 645 election by filing the election form. Form 8855, *"Election to Treat a Qualified Revocable Trust as Part of an Estate,"* will be available for making the section 645 election within six months after the publication of these final regulations.

Guidance has also been requested regarding when the section 645 election must be made if a Form 1041 *"U.S. Income Tax Return for Estates and Trusts,"* is not required to be filed for the first taxable year of the combined electing trust and related estate, if there is an executor, or of the electing trust if there is no executor, because the combined electing trust and related estate, or electing trust, as the case may be, does not have sufficient income to require the filing of a return. A commentator also suggested permitting the section 645 election to be made at any time during the three year period after the due date for the Form 1041 for the estate's first taxable year. The final regulations do not adopt this suggestion and clarify that, for the election to be valid, the election form must be filed not later than the time prescribed under section 6072 for filing the Form 1041 for the first taxable year of the combined electing trust and related estate, if there is an executor, or of the first taxable year of the electing trust, if there is no executor (regardless of whether there is sufficient income to require the filing of that return). If an extension is granted for the filing of the Form 1041 for the first taxable year of the combined electing trust and related estate, if there is an executor, or the electing trust, if there is no executor, the election form will be timely filed if it is filed by the time prescribed under section 6072 for filing the Form 1041 including the extension granted with respect to the Form 1041.

A commentator noted that, under the proposed regulations, an executor will have direct liability for the tax due on Forms

1041 filed for the combined electing trust and related estate. Accordingly, the executor can be personally liable for tax on the income from assets that are not under the executor's control. Further, the executor may not have sufficient assets in the estate to meet the income tax responsibilities of the combined electing trust and related estate. A commentator also noted that the requirement in the proposed regulations that the trustee agree to cooperate to insure that the Forms 1041 for the combined related estate and electing trust are timely filed and the tax due timely paid places the trustee in an untenable position because the executor controls the filing of the return and the payment of the tax.

The IRS and the Treasury Department note that under section 645, the electing trust is not treated as part of the related estate for purposes of Subtitle F of the Code. Accordingly, although the final regulations permit an electing trust and related estate to file a single, combined Form 1041, the electing trust and related estate continue to be separate taxpayers for purposes of Subtitle F, and the fiduciaries of the electing trust and the fiduciaries of the related estate each continue to have a responsibility for filing returns and paying the tax due for their respective entities even though a section 645 election has been made. Under the final regulations, the executor must file a complete, accurate, and timely Form 1041 for the combined related estate and electing trust for each taxable year during the election period. The trustee of the electing trust must timely provide the executor of the related estate with all the trust information necessary to permit the executor to file a complete, accurate, and timely Form 1041 for the combined electing trust and related estate for each taxable year during the election period. The trustee and the executor must allocate the tax burden of the combined electing trust and related estate in a manner that reasonably reflects the respective tax obligations of the electing trust and related estate. If the tax burden is not reasonably allocated, gifts may be deemed to have been made. The trustee is responsible for insuring that the electing trust's share of the tax burden is paid to the Secretary, and the executor is responsible for insuring that the related estate's share of the tax burden is timely paid to the Secretary.

C. *Comments and Changes to § 1.645–1(d): TIN and filing requirements for a QRT*

The proposed regulations provide that, in general, a grantor trust must obtain a taxpayer identification number (TIN) upon the death of the grantor regardless of whether or not the trust had a TIN prior to the death of the grantor. See proposed regulation § 301.6109–1(a)(3). The proposed regulations provide an exception to this general rule. The proposed regulations provide that, if there is an executor and a section 645 election has been made, a TIN must be obtained for the related estate but a TIN is not required to be obtained for the electing trust or for a QRT for which a section 645 election will be made. Further, under the proposed regulations, the payors (as defined in § 301.6109–1(a)(5) of these final regulations) of the electing trust or a QRT for which the section 645 election will be made are to be furnished with the TIN of the estate on Form W–9, *"Request for Taxpayer Identification Number and Certification."* The proposed regulations were designed to simplify and lessen the reporting burdens imposed on trustees and executors by the interim guidance in Rev. Proc. 98–13, 1998–1 C.B. 370, by removing the requirement to obtain a TIN for electing trusts and certain QRTs.

Several commentators reported, however, that many trustees automatically obtain a TIN for the QRT immediately after the decedent's death and furnish that TIN to payors. Under the proposed regulations, if a trustee obtains a TIN for a QRT, the trustee must file a completed Form 1041 for the QRT for the short taxable year of the QRT beginning with the decedent's date of death and ending December 31 of that year. If a valid section 645 election is made for the QRT, an amended Form 1041 must be filed for the QRT and the payors of the QRT must be furnished with a revised Form W–9 containing the related estate's TIN. As a result, for trustees that obtain a TIN for a QRT, the procedures in the proposed regulations are more burdensome than the procedures in Rev. Proc. 98–13. In response, the final regulations remove the provision in the proposed regulations that excepted an electing trust and a QRT for which a section 645 election will be made from the general requirement that a grantor trust must obtain a TIN upon the death of the grantor. Under the final regulations, the trustee of an electing trust or a QRT for which a section 645 election will be made obtains a TIN upon the death of the decedent as required by § 301.6109–1(a)(3) of these final regulations and furnishes this TIN to the payors of the trust. Under the final regulations, if a section 645 election will be made for a QRT, the trustee is not required to file a Form 1041 for the short taxable year of the QRT beginning with the decedent's date of death and ending December 31 of that year.

The final regulations also simplify the procedures for obtaining a TIN, furnishing that TIN to the payors, and filing a Form 1041 for a QRT if there is no executor. The proposed regulations provide that, if there is no executor, the trustee must obtain a TIN for the electing trust to file as an estate during the section 645 election period. The payors of the electing trust must be furnished with the TIN obtained by the trust to file as an estate. Under the proposed regulations, if a section 645 election will be made for a QRT, the trustee of the QRT may choose to obtain a TIN for the QRT to file as an estate under section 645 and avoid obtaining a TIN for the QRT to file as a trust. If the trustee of the QRT obtains a TIN to file as a trust (and not as an estate), the trustee is required to file a completed Form 1041 as a trust for the short taxable year of the QRT beginning with the decedent's date of death and ending December 31 of that year. If a section 645 election to treat the QRT as an estate is made after the Form 1041 is filed for the QRT treating the QRT as a trust, the trustee of the QRT is required to file an amended Form 1041 as a trust (excluding the items of income, deduction, and credits that are to be reported on a return filed as an estate), obtain another TIN to file as an estate, provide revised Forms W–9 with the new TIN to the payors of the QRT, and file a Form 1041 as an estate. Under the final regulations, if there is no executor, the trustee of an electing trust or a QRT for which a section 645 election will be made obtains a TIN upon the death of the decedent as required by § 301.6109–1(a)(3) of these final regulations and furnishes this TIN to the payors of the trust. The trustee uses this TIN to file Forms 1041 as an estate during the election period. If a section 645 election will be made for a QRT, the trustee of the QRT is not required to file a Form 1041 for the short taxable year be-

ginning with the decedent's date of death and ending December 31 of that year.

Regardless of whether or not there is an executor, the final regulations retain the requirement that a Form 1041 (including the items of income, deduction, and credit of the QRT) must be filed for the short taxable year of the QRT beginning with the decedent's date of death if a section 645 election will not be made for the trust, or if the trustee and the executor are uncertain whether a section 645 election will be made for the QRT by the due date of the Form 1041 for the short taxable year of the QRT beginning after the decedent's death and ending December 31 of that year.

D. *Comments and Changes to § 1.645–1(e): Tax Treatment and General Filing Requirements of the Electing Trust and Related Estate During the Election Period*

The proposed regulations provide that, during the election period, if there is an executor, one Form 1041 is filed annually for the combined electing trust and related estate under the name and TIN of the related estate. Information regarding the electing trust is also reported on the Form 1041 as required by the instructions to the Form 1041.

The proposed regulations provide that the electing trust and related estate are treated as separate shares under section 663(c) for purposes of computing distributable net income (DNI) and applying the distribution provisions of sections 661 and 662. The proposed regulations also provide rules for adjusting the DNI of the separate shares with respect to distributions made from one share to another share of the combined electing trust and related estate to which sections 661 and 662 would apply had the distribution been made to a beneficiary other than another share. Under the proposed regulations, the share making the distribution reduces its DNI by the amount of the distribution deduction that it would have been entitled to under section 661 had the distribution been made to a beneficiary other than another share of the combined related estate and electing trust, and, solely for purposes of calculating its DNI, the share receiving the distribution increases its gross income by this amount. One commentator noted that, if the amount distributed from one share to another share includes an item of DNI that is not included in the gross income of the combined electing trust and related estate, this provision in the proposed regulations does not produce an appropriate result because of the operation of section 661(c). Accordingly, the final regulations are revised to provide that the share making the distribution reduces its DNI by the amount of the distribution deduction it would be entitled to under section 661 (determined without regard to section 661(c)), and solely for purposes of calculating DNI, the share receiving the distribution increases its gross income by the same amount.

Commentators requested clarification regarding whether an electing trust will be treated as an estate or a trust for purposes of the rules under section 401(a)(9). Final regulations (T.D. 8987, 2002–19 I.R.B. 852) under sections 401, 403, and 408 were published in the **Federal Register** (67 FR 18988) on April 17, 2002. The preamble to those final regulations provides that an electing trust will not fail to be a trust for purposes of section 401(a)(9) merely because the trust elects to be treated as an estate under section 645, as long as the trust continues to be a trust under state law.

Another commentator asked for clarification regarding whether the exception for estates under section 6654(l)(2) with respect to the payment of estimated income tax applies to an electing trust. The final regulations clarify that each electing trust and related estate, if any, is treated as a separate taxpayer for all purposes of Subtitle F of the Code, including, without limitation, the application of section 6654. The final regulations provide, however, that the provisions of section 6654(l)(2)(A) relating to the 2 year exception to an estate's obligation to make estimated tax payments, will apply to each electing trust for which a section 645 election has been made.

E. *Comments and Changes to § 1.645–1(f): Duration of the Election Period*

The proposed regulations provide that the election period terminates on the day before the applicable date. One commentator suggested that section 645(a) should be interpreted as terminating the election period on the last day of the taxable year ending before the applicable date. Another commentator commended the interpretation taken by the proposed regulations because, if the estate is required to file a Form 706, *"United States Estate (and Generation Skipping Transfer) Tax Return,"* and the election terminates on the last day of the taxable year ending before the applicable date, the election period could terminate prior to the date of final determination of liability for the estate tax, rather than six months after that date. The final regulations continue to provide that the election terminates the day before the applicable date.

If a Form 706 is required to be filed, the proposed regulations provide that the applicable date is the day that is 6 months after the date of final determination of liability for the estate tax. In response to comments, the final regulations provide that the applicable date is the day that is the later of 2 years after the date of the decedent's death or 6 months after the date of final determination of liability for estate tax.

The proposed regulations provide that the date of final determination of liability for the estate tax is the day on which the first of a series of events has occurred. One of the events is the issuance of an estate tax closing letter, unless a claim for refund with respect to the estate tax is filed within six months after the issuance of the letter. Two commentators requested that the issuance of a closing letter be removed from the list of events that can be considered the date of final determination of liability. These commentators contended that the closing letter is not a final determination of liability because the IRS may impose additional estate tax after a closing letter has been issued.

The IRS and the Treasury Department note that the circumstances in which the IRS may impose additional estate tax after a closing letter is issued are very limited. See Rev. Proc. 94–68, 1994–2 C.B. 803. In many cases, the issuance of a closing letter is sufficient to permit the closing of the probate estate and to complete any administration of the electing trust that was necessitated by the decedent's death. The IRS and the Treasury Department believe that eliminating the closing letter from the list of events that are considered a final determination of liability may encourage unduly prolonging the administration of the electing trust and related estate in order to prolong the section 645 election period. While the final regulations retain the issuance of the closing letter as one of the triggers for the date of the final determi-

nation of liability, the final regulations have been changed to provide a minimum election period of two years for all electing trusts and related estates, as well as to provide that if the issuance of the closing letter triggers the date of the final determination of liability, the date of the final determination of liability is the date that is 6 months after the date the closing letter is issued, rather than the date the closing letter is issued as provided in the proposed regulations.

Proposed § 1.641(b)–3 provides that, if an estate has joined in making a valid section 645 election, the estate shall not terminate for federal tax purposes prior to the termination of the section 645 election period. Some interpreted proposed § 1.641 (b)–3 as requiring the filing of Forms 1041 for the estate until the applicable date even if, prior to that date, the electing trust and the related estate had been completely administered and the assets of the trust and the estate completely distributed. In response, the final regulations provide that the election period terminates on the earlier of the day on which both the electing trust and related estate, if any, have distributed all of their assets, or the day before the applicable date. The final regulations continue to provide that the election does not apply to successor trusts (trusts which are distributees under the trust instrument).

The proposed regulations provide that, if the executor of the related estate is not appointed until after the trustee has made a section 645 election, the section 645 election period will terminate if the later appointed executor refuses to agree to the election. One commentator objected to the termination of the election as a result of the refusal to agree to the election by the later appointed executor. This commentator suggested that the election period should continue after the appointment of the executor and that the person seeking appointment as an executor could either accept or not accept appointment as an executor given the responsibilities of the previously made section 645 election. The IRS and the Treasury Department believe that the later appointed executor must consent to the section 645 election for the election to be valid with respect to the related estate. Accordingly, the final regulations provide that, for the election period to continue, a new election form must be filed by the trustee and the newly appointed executor within 90 days of the executor's appointment. Otherwise, the election period terminates the day before the appointment of the executor.

F. *Tax Treatment of the Electing Trust and Related Estate Upon Termination of the Election Period*

At the close of the last day of the election period, the combined electing trust and related estate, if there is an executor, or the electing trust, if there is no executor, is deemed to distribute all the assets and liabilities of the share (or shares) comprising the electing trust to a new trust in a distribution to which sections 661 and 662 apply. Thus, the combined electing trust and related estate, or the electing trust, as appropriate, is entitled to a distribution deduction to the extent permitted under section 661 in the taxable year in which the election period terminates as a result of the deemed distribution. The new trust must include the amount of the deemed distribution in gross income to the extent required under section 662.

One commentator questioned whether the net capital gains attributable to the electing trust should be included in the sections 661 and 662 calculations for the deemed distribution of the electing trust to a new trust upon the termination of the election period. The final regulations clarify that the net capital gains attributable to the electing trust are includible in the DNI of the share (or shares) comprising the electing trust for the purpose of applying sections 661 and 662 to the deemed distribution to the new trust.

If there is an executor and the electing trust terminates on or before the termination of the section 645 election period, the trustee must file a final Form 1041 under the name and TIN of the electing trust to notify the IRS that the trust no longer exists. This Form 1041 will not include any of the trust's items of income, deduction, and credit because those items will be included on the Form 1041 filed for the combined electing trust and related estate.

If there is an executor, the trustee may not need to obtain a TIN for the new trust deemed to have been created upon the termination of the election period. The trustee must consult the instructions to the Form 1041 upon the termination of the election period to determine if a new TIN must be obtained. If a new TIN is not required to be obtained, the trustee must file Forms 1041 for the new trust under the TIN obtained by the trustee under § 301.6109–1(a)(3) for the QRT following the death of the decedent. If there is no executor, the trustee must obtain a TIN for the new trust deemed to have been created upon the termination of the election period. If a new TIN is required under the regulations or the instructions to the Form 1041, the trustee must file Forms W–9 with the payors of the trust to provide them with the TIN to be used following the termination of the election period.

G. *Effective date of final regulations under section 645*

The final regulations provide that election procedures in paragraph (c), the rules in paragraph (d) regarding obtaining a TIN for the electing trust and QRT, the rules in paragraph (f) regarding the duration of the election period, and paragraph (g) regarding the later appointed executor are effective for estates and trusts of decedents dying on or after December 24, 2002. The final regulations provide that the rules in paragraph (e), regarding the tax treatment and general filing requirements of the electing trust and the related estate, if any, during the election period, and the rules in paragraph (h) regarding the tax treatment of the electing trust and related estate, if any, upon termination of the election period are effective for taxable years ending on or after December 24, 2002. Estates and trusts of decedents dying before December 24, 2002, may follow the election procedures provided in the proposed regulations or Rev. Proc. 98–13. With respect to obtaining a TIN for a QRT and filing a Form 1041 for the short taxable year beginning with the decedent's death and ending December 31 of that year, estates and trusts of decedents dying before December 24, 2002, may follow the procedures in these final regulations, the proposed regulations, or Rev. Proc. 98–13.

H. *Clarification of the Reporting Rules for Grantor Trusts Under § 1.671–4*

The proposed regulations amend § 1.671–4 to clarify that a trust, or portion of a trust, reports under § 1.671–4 for the taxable year that ends with the death of the grantor or other person (decedent) treated as the owner of the trust. If the trust was filing a Form 1041 under § 1.671–4(a) during the life of the decedent, the due

date of the Form 1041 for the taxable year ending with the decedent's death is specified in § 1.6072–1(a)(2). Proposed § 1.6072–1(a)(2) provides that the due date for the Form 1041 for the taxable year ending with the death of the decedent is the fifteenth day of the fourth month following the close of the 12-month period which began with the first day of such fractional part of the year. The final regulations under § 1.6072–1(a)(2) are revised to provide that the due date for the Form 1041 filed for the taxable year ending with the decedent's death is the fifteenth day of the fourth month following the close of the 12-month period that began with the first day of the decedent's last taxable year.

Section 301.6109–1(a)(3) of the proposed regulations provides that a trust, all of which was treated as owned by the decedent, must obtain a new TIN upon the death of the decedent, if the trust will continue after the decedent's death. One commentator asked if this provision is intended to apply to an "administrative trust." Section 1.641(b)–3 recognizes that a trust does not automatically terminate upon the happening of the event by which the duration of the trust is measured. A reasonable period of time is permitted after such event for the trustee to perform the duties necessary to complete the administration of the trust. Section 301.6109–1(a)(3) is intended to clarify that a trust must obtain a new TIN after the death of the decedent, if a trust that was treated as owned by the decedent during the decedent's life will continue for a period of time following the death of the decedent to allow a winding up of the affairs of the trust following the death of the decedent.

For administrative convenience, the proposed regulations provide that if a decedent and others are treated as the owners of a trust and following the decedent's death the decedent's portion remains in the trust, the trust continues to report under the TIN used by the trust prior to the death of the decedent. Commentators found this provision confusing and asked for clarification. The final regulations clarify that this provision applies to a trust that has multiple grantors (or other persons treated as the owners) that must report under § 1.671–4(a) after the death of the decedent because, although a portion of the trust continues to be treated as owned by a grantor or another person, the decedent's portion of the trust is no longer treated as owned by the decedent upon his death. The final regulations provide an example of a situation in which this provision applies.

Effect on Other Documents

The following publications are obsolete as of December 24, 2002:

Revenue Procedure 98–13, 1998–1 C.B. 370

Notice 2001–26, 2001–13 I.R.B. 942

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply and because this rule does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Faith Colson, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.645–1 also issued under 26 U.S.C. 645. * * *

Par. 2. Section 1.641(b)–3 is amended by adding a sentence to the end of paragraph (a) to read as follows:

§ 1.641(b)–3 Termination of estates and trusts.

(a) * * * Notwithstanding the above, if the estate has joined in making a valid election under section 645 to treat a qualified revocable trust, as defined under section 645(b)(1), as part of the estate, the estate shall not terminate under this paragraph prior to the termination of the section 645 election period. See section 645 and the regulations thereunder for rules regarding the termination of the section 645 election period.

* * * * *

Par. 3. In § 1.642(c)–1, the last sentence of paragraph (a)(1) is revised to read as follows:

§ 1.642(c)–1 Unlimited deduction for amounts paid for a charitable purpose.

(a) * * * (1) * * * In applying this paragraph without reference to paragraph (b) of this section, a deduction shall be allowed for an amount paid during the taxable year in respect of gross income received in a previous taxable year, but only if no deduction was allowed for any previous taxable year to the estate or trust, or in the case of a section 645 election, to a related estate, as defined under § 1.645–1(b), for the amount so paid.

* * * * *

Par. 4. An undesignated center heading is added immediately after § 1.642(c)–6(A) to read as follows:

"Election to Treat Trust as Part of an Estate"

Par. 5. Section 1.645–1 is added under the new undesignated centerheading "Election to Treat Trust as Part of an Estate" to read as follows:

§ 1.645–1 Election by certain revocable trusts to be treated as part of estate.

(a) *In general.* If an election is filed for a qualified revocable trust, as defined in paragraph (b)(1) of this section, in accordance with the rules set forth in paragraph (c) of this section, the qualified revocable trust is treated and taxed for purposes of subtitle A of the Internal Revenue Code as part of its related estate, as defined in paragraph (b)(5) of this section (and not as a separate trust) during the election period, as defined in paragraph (b)(6) of this section. Rules regarding the use of taxpayer identification numbers (TINs) and the fil-

ing of a Form 1041, *"U.S. Income Tax Return for Estates and Trusts,"* for a qualified revocable trust are in paragraph (d) of this section. Rules regarding the tax treatment of an electing trust and related estate and the general filing requirements for the combined entity during the election period are in paragraph (e)(2) of this section. Rules regarding the tax treatment of an electing trust and its filing requirements during the election period if no executor, as defined in paragraph (b)(4) of this section, is appointed for a related estate are in paragraph (e)(3) of this section. Rules for determining the duration of the section 645 election period are in paragraph (f) of this section. Rules regarding the tax effects of the termination of the election are in paragraph (h) of this section. Rules regarding the tax consequences of the appointment of an executor after a trustee has made a section 645 election believing that an executor would not be appointed for a related estate are in paragraph (g) of this section.

(b) *Definitions.* For purposes of this section:

(1) *Qualified revocable trust.* A *qualified revocable trust* (QRT) is any trust (or portion thereof) that on the date of death of the decedent was treated as owned by the decedent under section 676 by reason of a power held by the decedent (determined without regard to section 672(e)). A trust that was treated as owned by the decedent under section 676 by reason of a power that was exercisable by the decedent only with the approval or consent of a nonadverse party or with the approval or consent of the decedent's spouse is a QRT. A trust that was treated as owned by the decedent under section 676 solely by reason of a power held by a nonadverse party or by reason of a power held by the decedent's spouse is not a QRT.

(2) *Electing trust.* An *electing trust* is a QRT for which a valid section 645 election has been made. Once a section 645 election has been made for the trust, the trust shall be treated as an electing trust throughout the entire election period.

(3) *Decedent.* The *decedent* is the individual who was treated as the owner of the QRT under section 676 on the date of that individual's death.

(4) *Executor.* An *executor* is an executor, personal representative, or administrator that has obtained letters of appointment to administer the decedent's estate through formal or informal appointment procedures. Solely for purposes of this paragraph (b)(4), an executor does not include a person that has actual or constructive possession of property of the decedent unless that person is also appointed or qualified as an executor, administrator, or personal representative of the decedent's estate. If more that one jurisdiction has appointed an executor, the executor appointed in the domiciliary or primary proceeding is the executor of the related estate for purposes of this paragraph (b)(4).

(5) *Related estate.* A *related estate* is the estate of the decedent who was treated as the owner of the QRT on the date of the decedent's death.

(6) *Election period.* The *election period* is the period of time during which an electing trust is treated and taxed as part of its related estate. The rules for determining the duration of the election period are in paragraph (f) of this section.

(c) *The election*—(1) *Filing the election if there is an executor*—(i) *Time and manner for filing the election.* If there is an executor of the related estate, the trustees of each QRT joining in the election and the executor of the related estate make an election under section 645 and this section to treat each QRT joining in the election as part of the related estate for purposes of subtitle A of the Internal Revenue Code by filing a form provided by the IRS for making the election (election form) properly completed and signed under penalties of perjury, or in any other manner prescribed after December 24, 2002, by forms provided by the Internal Revenue Service (IRS), or by other published guidance for making the election. For the election to be valid, the election form must be filed not later than the time prescribed under section 6072 for filing the Form 1041 for the first taxable year of the related estate (regardless of whether there is sufficient income to require the filing of that return). If an extension is granted for the filing of the Form 1041 for the first taxable year of the related estate, the election form will be timely filed if it is filed by the time prescribed for filing the Form 1041 including the extension granted with respect to the Form 1041.

(ii) *Conditions to election.* In addition to providing the information required by the election form, as a condition to a valid section 645 election, the trustee of each QRT joining in the election and the executor of the related estate agree, by signing the election form under penalties of perjury, that:

(A) With respect to a trustee—

(*1*) The trustee agrees to the election;

(*2*) The trustee is responsible for timely providing the executor of the related estate with all the trust information necessary to permit the executor to file a complete, accurate, and timely Form 1041 for the combined electing trust(s) and related estate for each taxable year during the election period;

(*3*) The trustee of each QRT joining the election and the executor of the related estate have agreed to allocate the tax burden of the combined electing trust(s) and related estate for each taxable year during the election period in a manner that reasonably reflects the tax obligations of each electing trust and the related estate; and

(*4*) The trustee is responsible for insuring that the electing trust's share of the tax obligations of the combined electing trust(s) and related estate is timely paid to the Secretary.

(B) With respect to the executor—

(*1*) The executor agrees to the election;

(*2*) The executor is responsible for filing a complete, accurate, and timely Form 1041 for the combined electing trust(s) and related estate for each taxable year during the election period;

(*3*) The executor and the trustee of each QRT joining in the election have agreed to allocate the tax burden of the combined electing trust(s) and related estate for each taxable year during the election period in a manner that reasonably reflects the tax obligations of each electing trust and the related estate;

(*4*) The executor is responsible for insuring that the related estate's share of the tax obligations of the combined electing trust(s) and related estate is timely paid to the Secretary.

(2) *Filing the election if there is no executor*—(i) *Time and manner for filing the election.* If there is no executor for a related estate, an election to treat one or more QRTs of the decedent as an estate for purposes of subtitle A of the Internal Revenue Code is made by the trustees of each QRT joining in the election, by filing a properly completed election form, or in any other manner prescribed after December 24, 2002, by forms provided by the IRS, or by

other published guidance for making the election. For the election to be valid, the election form must be filed not later than the time prescribed under section 6072 for filing the Form 1041 for the first taxable year of the trust, taking into account the trustee's election to treat the trust as an estate under section 645 (regardless of whether there is sufficient income to require the filing of that return). If an extension is granted for the filing of the Form 1041 for the first taxable year of the electing trust, the election form will be timely filed if it is filed by the time prescribed for filing the Form 1041 including the extension granted with respect to the filing of the Form 1041.

(ii) *Conditions to election.* In addition to providing the information required by the election form, as a condition to a valid section 645 election, the trustee of each QRT joining in the election agrees, by signing the election form under penalties of perjury, that—

(A) The trustee agrees to the election;

(B) If there is more than one QRT joining in the election, the trustees of each QRT joining in the election have appointed one trustee to be responsible for filing the Form 1041 for the combined electing trusts for each taxable year during the election period (filing trustee) and the filing trustee has agreed to accept that responsibility;

(C) If there is more than one QRT, the trustees of each QRT joining in the election have agreed to allocate the tax liability of the combined electing trusts for each taxable year during the election period in a manner that reasonably reflects the tax obligations of each electing trust;

(D) The trustee agrees to:

(*1*) Timely file a Form 1041 for the electing trust(s) for each taxable year during the election period; or

(*2*) If there is more than one QRT and the trustee is not the filing trustee, timely provide the filing trustee with all of the electing trust's information necessary to permit the filing trustee to file a complete, accurate, and timely Form 1041 for the combined electing trusts for each taxable year during the election period;

(*3*) Insure that the electing trust's share of the tax burden is timely paid to the Secretary;

(E) There is no executor and, to the knowledge and belief of the trustee, one will not be appointed; and

(F) If an executor is appointed after the filing of the election form and the executor agrees to the section 645 election, the trustee will complete and file a revised election form with the executor.

(3) *Election for more than one QRT.* If there is more than one QRT, the election may be made for some or all of the QRTs. If there is no executor, one trustee must be appointed by the trustees of the electing trusts to file Forms 1041 for the combined electing trusts filing as an estate during the election period.

(d) *TIN and filing requirements for a QRT*—(1) *Obtaining a TIN.* Regardless of whether there is an executor for a related estate and regardless of whether a section 645 election will be made for the QRT, a TIN must be obtained for the QRT following the death of the decedent. See § 301.6109–1(a)(3) of this chapter. The trustee must furnish this TIN to the payors of the QRT. See § 301.6109–1(a)(5) of this chapter for the definition of payor.

(2) *Filing a Form 1041 for a QRT*—(i) *Option not to file a Form 1041 for a QRT for which a section 645 election will be made.* If a section 645 election will be made for a QRT, the executor of the related estate, if any, and the trustee of the QRT may treat the QRT as an electing trust from the decedent's date of death until the due date for the section 645 election. Accordingly, the trustee of the QRT is not required to file a Form 1041 for the QRT for the short taxable year beginning with the decedent's date of death and ending December 31 of that year. However, if a QRT is treated as an electing trust under this paragraph from the decedent's date of death until the due date for the section 645 election but a valid section 645 election is not made for the QRT, the QRT will be subject to penalties and interest for failing to timely file a Form 1041 and pay the tax due thereon.

(ii) *Requirement to file a Form 1041 for a QRT if paragraph (d)(2)(i) of this section does not apply*—(A) *Requirement to file Form 1041.* If the trustee of the QRT and the executor of the related estate, if any, do not treat the QRT as an electing trust as provided under paragraph (d)(2)(i) of this section, or if the trustee of the electing trust and the executor, if any, are uncertain whether a section 645 election will be made for a QRT, the trustee of the QRT must file a Form 1041 for the short taxable year beginning with the decedent's death and ending December 31 of that year (unless the QRT is not required to file a Form 1041 under section 6012 for this period).

(B) *Requirement to amend Form 1041 if a section 645 election is made—(1) If there is an executor.* If there is an executor and a valid section 645 election is made for a QRT after a Form 1041 has been filed for the QRT as a trust (see paragraph (d)(2)(ii)(A) of this section), the trustee must amend the Form 1041. The QRT's items of income, deduction, and credit must be excluded from the amended Form 1041 filed under this paragraph and must be included on the Form 1041 filed for the first taxable year of the combined electing trust and related estate under paragraph (e)(2)(ii)(A) of this section.

(*2*) *If there is no executor.* If there is no executor and a valid section 645 election is made for a QRT after a Form 1041 has been filed for the QRT as a trust (see paragraph (d)(2)(ii)(A) of this section) for the short taxable year beginning with the decedent's death and ending December 31 of that year, the trustee must file an amended return for the QRT. The amended return must be filed consistent with paragraph (e)(3) of this section and must be filed by the due date of the Form 1041 for the QRT, taking into account the trustee's election under section 645.

(e) *Tax treatment and general filing requirements of electing trust and related estate during the election period*—(1) *Effect of election.* The section 645 election once made is irrevocable.

(2) *If there is an executor*—(i) *Tax treatment of the combined electing trust and related estate*. If there is an executor, the electing trust is treated, during the election period, as part of the related estate for all purposes of subtitle A of the Internal Revenue Code. Thus, for example, the electing trust is treated as part of the related estate for purposes of the set-aside deduction under section 642(c)(2), the subchapter S shareholder requirements of section 1361(b)(1), and the special offset for rental real estate activities in section 469(i)(4).

(ii) *Filing requirements*—(A) *Filing the Form 1041 for the combined electing trust and related estate during the election period.* If there is an executor, the executor files a single income tax return annually (assuming a return is required under section 6012) under the name and TIN of the re-

lated estate for the combined electing trust and the related estate. Information regarding the name and TIN of each electing trust must be provided on the Form 1041 as required by the instructions to that form. The period of limitations provided in section 6501 for assessments with respect to an electing trust and the related estate starts with the filing of the return required under this paragraph. Except as required under the separate share rules of section 663(c), for purposes of filing the Form 1041 under this paragraph and computing the tax, the items of income, deduction, and credit of the electing trust and related estate are combined. One personal exemption in the amount of $600 is permitted under section 642(b), and the tax is computed under section 1(e), taking into account section 1(h), for the combined taxable income.

(B) *Filing a Form 1041 for the electing trust is not required.* Except for any final Form 1041 required to be filed under paragraph (h)(2)(i)(B) of this section, if there is an executor, the trustee of the electing trust does not file a Form 1041 for the electing trust during the election period. Although the trustee is not required to file a Form 1041 for the electing trust, the trustee of the electing trust must timely provide the executor of the related estate with all the trust information necessary to permit the executor to file a complete, accurate and timely Form 1041 for the combined electing trust and related estate. The trustee must also insure that the electing trust's share of the tax obligations of the combined electing trust and related estate is timely paid to the Secretary. In certain situations, the trustee of a QRT may be required to file a Form 1041 for the QRT's short taxable year beginning with the date of the decedent's death and ending December 31 of that year. See paragraph (d)(2) of this section.

(iii) *Application of the separate share rules*—(A) *Distributions to beneficiaries (other than to a share (or shares) of the combined electing trust and related estate).* Under the separate share rules of section 663(c), the electing trust and related estate are treated as separate shares for purposes of computing distributable net income (DNI) and applying the distribution provisions of sections 661 and 662. Further, the electing trust share or the related estate share may each contain two or more shares. Thus, if during the taxable year, a distribution is made by the electing trust or the related estate, the DNI of the share making the distribution must be determined and the distribution provisions of sections 661 and 662 must be applied using the separately determined DNI applicable to the distributing share.

(B) *Adjustments to the DNI of the separate shares for distributions between shares to which sections 661 and 662 would apply.* A distribution from one share to another share to which sections 661 and 662 would apply if made to a beneficiary other than another share of the combined electing trust and related estate affects the computation of the DNI of the share making the distribution and the share receiving the distribution. The share making the distribution reduces its DNI by the amount of the distribution deduction that it would be entitled to under section 661 (determined without regard to section 661(c)), had the distribution been made to another beneficiary, and, solely for purposes of calculating DNI, the share receiving the distribution increases its gross income by the same amount. The distribution has the same character in the hands of the recipient share as in the hands of the distributing share. The following example illustrates the provisions of this paragraph (e)(2)(iii)(B):

Example. (i) A's will provides that, after the payment of debts, expenses, and taxes, the residue of A's estate is to be distributed to Trust, an electing trust. The sole beneficiary of Trust is C. The estate share has $15,000 of gross income, $5,000 of deductions, and $10,000 of taxable income and DNI for the taxable year based on the assets held in A's estate. During the taxable year, A's estate distributes $15,000 to Trust. The distribution reduces the DNI of the estate share by $10,000.

(ii) For the same taxable year, the trust share has $25,000 of gross income and $5,000 of deductions. None of the modifications provided for under section 643(a) apply. In calculating the DNI for the trust share, the gross income of the trust share is increased by $10,000, the amount of the reduction in the DNI of the estate share as a result of the distribution to Trust. Thus, solely for purposes of calculating DNI, the trust share has gross income of $35,000, and taxable income of $30,000. Therefore, the trust share has $30,000 of DNI for the taxable year.

(iii) During the same taxable year, Trust distributes $35,000 to C. The distribution deduction reported on the Form 1041 filed for A's estate and Trust is $30,000. As a result of the distribution by Trust to C, C must include $30,000 in gross income for the taxable year. The gross income reported on the Form 1041 filed for A's estate and Trust is $40,000.

(iv) *Application of the governing instrument requirement of section 642(c).* A deduction is allowed in computing the taxable income of the combined electing trust and related estate to the extent permitted under section 642(c) for—

(A) Any amount of the gross income of the related estate that is paid or set aside during the taxable year pursuant to the terms of the governing instrument of the related estate for a purpose specified in section 170(c); and

(B) Any amount of gross income of the electing trust that is paid or set aside during the taxable year pursuant to the terms of the governing instrument of the electing trust for a purpose specified in section 170(c).

(3) *If there is no executor*—(i) *Tax treatment of the electing trust.* If there is no executor, the trustee treats the electing trust, during the election period, as an estate for all purposes of subtitle A of the Internal Revenue Code. Thus, for example, an electing trust is treated as an estate for purposes of the set-aside deduction under section 642(c)(2), the subchapter S shareholder requirements of section 1361(b)(1), and the special offset for rental real estate activities under section 469(i)(4). The trustee may also adopt a taxable year other than a calendar year.

(ii) *Filing the Form 1041 for the electing trust.* If there is no executor, the trustee of the electing trust must, during the election period, file a Form 1041, under the TIN obtained by the trustee under § 301.6109–1(a)(3) of this chapter upon the death of the decedent, treating the trust as an estate. If there is more than one electing trust, the Form 1041 must be filed by the filing trustee (see paragraph (c)(2)(ii)(B) of this section) under the name and TIN of the electing trust of the filing trustee. Information regarding the names and TINs of the other electing trusts must be provided on the Form 1041 as required by the instructions to that form. Any return filed in accordance with this paragraph shall be treated as a return filed for the electing trust (or trusts, if there is more than one electing trust) and not as a return filed for any subsequently discovered related estate. Accordingly, the period of limitations provided in section 6501 for assessments with respect to a subsequently discovered related estate does not start until a return is filed with respect to the related estate. See paragraph (g) of this section.

(4) *Application of the section 6654(l)(2) to the electing trust.* Each electing trust and related estate (if any) is treated as a sepa-

rate taxpayer for all purposes of subtitle F of the Internal Revenue Code, including, without limitation, the application of section 6654. The provisions of section 6654(l)(2)(A) relating to the two year exception to an estate's obligation to make estimated tax payments, however, will apply to each electing trust for which a section 645 election has been made.

(f) *Duration of election period*—(1) *In general*. The election period begins on the date of the decedent's death and terminates on the earlier of the day on which both the electing trust and related estate, if any, have distributed all of their assets, or the day before the applicable date. The election does not apply to successor trusts (trusts that are distributees under the trust instrument).

(2) *Definition of applicable date*—(i) *Applicable date if no Form 706 "United States Estate (and Generation Skipping Transfer) Tax Return" is required to be filed.* If a Form 706 is not required to be filed as a result of the decedent's death, the applicable date is the day which is 2 years after the date of the decedent's death.

(ii) *Applicable date if a Form 706 is required to be filed*. If a Form 706 is required to be filed as a result of the decedent's death, the applicable date is the later of the day that is 2 years after the date of the decedent's death, or the day that is 6 months after the date of final determination of liability for estate tax. Solely for purposes of determining the applicable date under section 645, the date of final determination of liability is the earliest of the following—

(A) The date that is six months after the issuance by the Internal Revenue Service of an estate tax closing letter, unless a claim for refund with respect to the estate tax is filed within twelve months after the issuance of the letter;

(B) The date of a final disposition of a claim for refund, as defined in paragraph (f)(2)(iii) of this section, that resolves the liability for the estate tax, unless suit is instituted within six months after a final disposition of the claim;

(C) The date of execution of a settlement agreement with the Internal Revenue Service that determines the liability for the estate tax;

(D) The date of issuance of a decision, judgment, decree, or other order by a court of competent jurisdiction resolving the liability for the estate tax unless a notice of appeal or a petition for *certiorari* is filed within 90 days after the issuance of a decision, judgment, decree, or other order of a court; or

(E) The date of expiration of the period of limitations for assessment of the estate tax provided in section 6501.

(iii) *Definition of final disposition of claim for refund*. For purposes of paragraph (f)(2)(ii)(B) of this section, a claim for refund shall be deemed finally disposed of by the Secretary when all items have been either allowed or disallowed. If a waiver of notification with respect to disallowance is filed with respect to a claim for refund prior to disallowance of the claim, the claim for refund will be treated as disallowed on the date the waiver is filed.

(iv) *Examples.* The application of this paragraph (f)(2) is illustrated by the following examples:

Example 1. A died on October 20, 2002. The executor of *A*'s estate and the trustee of Trust, an electing trust, made a section 645 election. A Form 706 is not required to be filed as a result of *A*'s death. The applicable date is October 20, 2004, the day that is two years after *A*'s date of death. The last day of the election period is October 19, 2004. Beginning October 20, 2004, Trust will no longer be treated and taxed as part of *A*'s estate.

Example 2. Assume the same facts as *Example 1*, except that a Form 706 is required to be filed as the result of *A*'s death. The Internal Revenue Service issues an estate tax closing letter accepting the Form 706 as filed on March 15, 2005. The estate does not file a claim for refund by March 15, 2006, the day that is twelve months after the date of issuance of the estate tax closing letter. The date of final determination of liability is September 15, 2005, and the applicable date is March 15, 2006. The last day of the election period is March 14, 2006. Beginning March 15, 2006, Trust will no longer be treated and taxed as part of *A*'s estate.

Example 3. Assume the same facts as *Example 1*, except that a Form 706 is required to be filed as the result of *A*'s death. The Form 706 is audited, and a notice of deficiency authorized under section 6212 is mailed to the executor of *A*'s estate as a result of the audit. The executor files a petition in Tax Court. The Tax Court issues a decision resolving the liability for estate tax on December 14, 2005, and neither party appeals within 90 days after the issuance of the decision. The date of final determination of liability is December 14, 2005. The applicable date is June 14, 2006, the day that is six months after the date of final determination of liability. The last day of the election period is June 13, 2006. Beginning June 14, 2006, Trust will no longer be treated and taxed as part of *A*'s estate.

(g) *Executor appointed after the section 645 election is made*—(1) *Effect on the election.* If an executor for the related estate is not appointed until after the trustee has made a valid section 645 election, the executor must agree to the trustee's election, and the IRS must be notified of that agreement by the filing of a revised election form (completed as required by the instructions to that form) within 90 days of the appointment of the executor, for the election period to continue past the date of appointment of the executor. If the executor does not agree to the election or a revised election form is not timely filed as required by this paragraph, the election period terminates the day before the appointment of the executor. If the IRS issues other guidance after December 24, 2002, for notifying the IRS of the executor's agreement to the election, the IRS must be notified in the manner provided in that guidance for the election period to continue.

(2) *Continuation of election period*—(i) *Correction of returns filed before executor appointed.* If the election period continues under paragraph (g)(1) of this section, the executor of the related estate and the trustee of each electing trust must file amended Forms 1041 to correct the Forms 1041 filed by the trustee before the executor was appointed. The amended Forms 1041 must be filed under the name and TIN of the electing trust and must reflect the items of income, deduction, and credit of the related estate and the electing trust. The name and TIN of the related estate must be provided on the amended Forms 1041 as required in the instructions to that Form. The amended return for the taxable year ending immediately before the executor was appointed must indicate that this Form 1041 is a final return. If the period of limitations for making assessments has expired with respect to the electing trust for any of the Forms 1041 filed by the trustee, the executor must file Forms 1041 for any items of income, deduction, and credit of the related estate that cannot be properly included on amended forms for the electing trust. The personal exemption under section 642(b) is not permitted to be taken on these Forms 1041 filed by the executor.

(ii) *Returns filed after the appointment of the executor.* All returns filed by the combined electing trust and related estate after the appointment of the executor are to be filed under the name and TIN of the related estate in accordance with paragraph (e)(2) of this section. Regardless of the change in the name and TIN under which the Forms 1041 for the combined electing trust and related estate are filed, the

combined electing trust and related estate will be treated as the same entity before and after the executor is appointed.

(3) *Termination of the election period.* If the election period terminates under paragraph (g)(1) of this section, the executor must file Forms 1041 under the name and TIN of the estate for all taxable years of the related estate ending after the death of the decedent. The trustee of the electing trust is not required to amend any returns filed for the electing trust during the election period. Following termination of the election period, the trustee of the electing trust must obtain a new TIN. See § 301.6109–1(a)(4) of this chapter.

(h) *Treatment of an electing trust and related estate following termination of the election*—(1) *The share (or shares) comprising the electing trust is deemed to be distributed upon termination of the election period.* On the close of the last day of the election period, the combined electing trust and related estate, if there is an executor, or the electing trust, if there is no executor, is deemed to distribute the share (or shares, as determined under section 663(c)) comprising the electing trust to a new trust in a distribution to which sections 661 and 662 apply. All items of income, including net capital gains, that are attributable to the share (or shares) comprising the electing trust are included in the calculation of the distributable net income of the electing trust and treated as distributed by the combined electing trust and related estate, if there is an executor, or by the electing trust, if there is no executor, to the new trust. The combined electing trust and related estate, if there is an executor, or the electing trust, if there is no executor, is entitled to a distribution deduction to the extent permitted under section 661 in the taxable year in which the election period terminates as a result of the deemed distribution. The new trust shall include the amount of the deemed distribution in gross income to the extent required under section 662.

(2) *Filing of the Form 1041 upon the termination of the section 645 election*—(i) *If there is an executor*—(A) *Filing the Form 1041 for the year of termination.* If there is an executor, the Form 1041 filed under the name and TIN of the related estate for the taxable year in which the election terminates includes—

(*1*) The items of income, deduction, and credit of the electing trust attributable to the period beginning with the first day of the taxable year of the combined electing trust and related estate and ending with the last day of the election period;

(*2*) The items of income, deduction, and credit, if any, of the related estate for the entire taxable year; and

(*3*) A deduction for the deemed distribution of the share (or shares) comprising the electing trust to the new trust as provided for under paragraph (h)(1) of this section.

(B) *Requirement to file a final Form 1041 under the name and TIN of the electing trust.* If the electing trust terminates during the election period, the trustee of the electing trust must file a Form 1041 under the name and TIN of the electing trust and indicate that the return is a final return to notify the IRS that the electing trust is no longer in existence. The items of income, deduction, and credit of the trust are not reported on this final Form 1041 but on the appropriate Form 1041 filed for the combined electing trust and related estate.

(ii) *If there is no executor.* If there is no executor, the taxable year of the electing trust closes on the last day of the election period. A Form 1041 is filed in the manner prescribed under paragraph (e)(3)(ii) of this section reporting the items of income, deduction, and credit of the electing trust for the short period ending with the last day of the election period. The Form 1041 filed under this paragraph includes a distribution deduction for the deemed distribution provided for under paragraph (h)(1) of this section. The Form 1041 must indicate that it is a final return.

(3) *Use of TINs following termination of the election*—(i) *If there is an executor.* Upon termination of the section 645 election, a former electing trust may need to obtain a new TIN. See § 301.6109–1(a)(4) of this chapter. If the related estate continues after the termination of the election period, the related estate must continue to use the TIN assigned to the estate during the election period.

(ii) *If there is no executor.* If there is no executor, the former electing trust must obtain a new TIN if the trust will continue after the termination of the election period. See § 301.6109–1(a)(4) of this chapter.

(4) *Taxable year of estate and trust upon termination of the election*—(i) *Estate*—Upon termination of the section 645 election period, the taxable year of the estate is the same taxable year used during the election period.

(ii) *Trust*. Upon termination of the section 645 election, the taxable year of the new trust is the calendar year. See section 644.

(i) *Reserved.*

(j) *Effective date.* Paragraphs (a), (b), (c), (d), (f), and (g) of this section apply to trusts and estates of decedents dying on or after December 24, 2002. Paragraphs (e) and (h) of this section apply to taxable years ending on or after December 24, 2002.

Par. 6. Section 1.671–4 is amended as follows:

1. The text of paragraph (d) is redesignated paragraph (d)(1) and a paragraph heading is added for newly designated paragraph (d)(1).

2. Paragraph (d)(2) is added.

3. Paragraphs (h) and (i) are redesignated as paragraphs (i) and (j), respectively.

4. New paragraph (h) is added.

5. The text of newly designated paragraph (i)(1) is revised.

6. Paragraph (i)(3) is added.

The additions and revisions read as follows:

§ 1.671–4 Method of reporting.

* * * * *

(d) *Due date and other requirements with respect to statement required to be furnished by trustee*—(1) *In general*. * * *

(2) *Statement for the taxable year ending with the death of the grantor or other person treated as the owner of the trust.* If a trust ceases to be treated as owned by the grantor, or other person, by reason of the death of that grantor or other person (decedent), the due date for the statement required to be furnished for the taxable year ending with the death of the decedent shall be the date specified by section 6034A(a) as though the decedent had lived throughout the decedent's last taxable year. See paragraph (h) of this section for special reporting rules for a trust or portion of the trust that ceases to be treated as owned by the grantor or other person by reason of the death of the grantor or other person.

* * * * *

(h) *Reporting rules for a trust, or portion of a trust, that ceases to be treated as*

owned by a grantor or other person by reason of the death of the grantor or other person—(1) *Definition of decedent.* For purposes of this paragraph (h), the *decedent* is the grantor or other person treated as the owner of the trust, or portion of the trust, under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code on the date of death of that person.

(2) *In general.* The provisions of this section apply to a trust, or portion of a trust, treated as owned by a decedent for the taxable year that ends with the decedent's death. Following the death of the decedent, the trust or portion of a trust that ceases to be treated as owned by the decedent, by reason of the death of the decedent, may no longer report under this section. A trust, all of which was treated as owned by the decedent, must obtain a new TIN upon the death of the decedent, if the trust will continue after the death of the decedent. See § 301.6109–1(a)(3)(i) of this chapter for rules regarding obtaining a TIN upon the death of the decedent.

(3) *Special rules*—(i) *Trusts reporting pursuant to paragraph (a) of this section for the taxable year ending with the decedent's death.* The due date for the filing of a return pursuant to paragraph (a) of this section for the taxable year ending with the decedent's death shall be the due date provided for under § 1.6072–1(a)(2). The return filed under this paragraph for a trust all of which was treated as owned by the decedent must indicate that it is a final return.

(ii) *Trust reporting pursuant to paragraph (b)(2)(B) of this section for the taxable year of the decedent's death.* A trust that reports pursuant to paragraph (b)(2)(B) of this section for the taxable year ending with the decedent's death must indicate on each Form 1096 "*Annual Summary and Transmittal of the U.S. Information Returns*" that it files (or appropriately on magnetic media) for the taxable year ending with the death of the decedent that it is the final return of the trust.

(iii) *Trust reporting under paragraph (b)(3) of this section.* If a trust has been reporting under paragraph (b)(3) of this section, the trustee may not report under that paragraph if any portion of the trust has a short taxable year by reason of the death of the decedent and the portion treated as owned by the decedent does not terminate on the death of the decedent.

(i) *Effective date and transition rule*—(1) *Effective date.* The trustee of a trust any portion of which is treated as owned by one or more grantors or other persons must report pursuant to paragraphs (a), (b), (c), (d)(1), (e), (f), and (g) of this section for taxable years beginning on or after January 1, 1996.

* * * * *

(3) *Effective date for paragraphs (d)(2) and (h) of this section.*

Paragraphs (d)(2) and (h) of this section apply for taxable years ending on or after December 24, 2002.

Par. 7. Section 1.6012–3 is amended by adding paragraph (a)(1)(iv) to read as follows:

§ 1.6012–3 Returns by fiduciaries.

(iv) For each trust electing to be taxed as, or as part of, an estate under section 645 for which a trustee acts, and for each related estate joining in a section 645 election for which an executor acts, if the aggregate gross income of the electing trust(s) and related estate, if any, joining in the election for the taxable year is $600 or more. (For the respective filing requirements of the trustee of each electing trust and executor of any related estate, see § 1.645–1).

* * * * *

Par. 8. Section 1.6072–1 is amended as follows:

1. The text of paragraph (a) is redesignated as paragraph (a)(1) and a paragraph heading is added for newly designated paragraph (a)(1).

2. Paragraph (a)(2) is added.

The additions are as follows:

§ 1.6072–1 Time for filing returns of individuals, estates, and trusts.

(a) *In general*—(1) *Returns of income for individuals, estates and trusts.* * * *

(2) *Return of trust, or portion of a trust, treated as owned by a decedent*—(i) *In general.* In the case of a return of a trust, or portion of a trust, that was treated as owned by a decedent under subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code as of the date of the decedent's death that is filed in accordance with § 1.671–4(a) for the fractional part of the year ending with the date of the decedent's death, the due date of such return shall be the fifteenth day of the fourth month following the close of the 12-month period which began with the first day of the decedent's taxable year.

(ii) *Effective date.* This paragraph (a)(2) applies to taxable years ending on or after December 24, 2002.

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 9. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 10. Section 301.6109–1 is amended as follows:

1. Paragraph (a)(2)(iii) is removed.

2. Paragraphs (a)(3) through (a)(6) are added.

The additions are as follows:

§ 301.6109–1 Identifying numbers.

(a) * * *

(3) *Obtaining a taxpayer identification number for a trust, or portion of a trust, following the death of the individual treated as the owner*—(i) *In general*—(A) *A trust all of which was treated as owned by a decedent.* In general, a trust all of which is treated as owned by a decedent under subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code as of the date of the decedent's death must obtain a new taxpayer identification number following the death of the decedent if the trust will continue after the death of the decedent.

(B) *Taxpayer identification number of trust with multiple owners.* With respect to a portion of a trust treated as owned under subpart E (section 671 and following), part I, subchapter J, chapter 1 (subpart E) of the Internal Revenue Code by a decedent as of the date of the decedent's death, if, following the death of the decedent, the portion treated as owned by the decedent remains part of the original trust and the other portion (or portions) of the trust continues to be treated as owned under subpart E by a grantor(s) or other person(s), the trust reports under the taxpayer identification number assigned to the trust prior to the decedent's death and the portion of the trust treated as owned by the decedent prior to the decedent's death (assuming the decedent's portion of the trust is not treated as terminating upon the decedent's death) continues to report under the

taxpayer identification number used for reporting by the other portion (or portions) of the trust. For example, if a trust, reporting under § 1.671–4(a) of this chapter, is treated as owned by three persons and one of them dies, the trust, including the portion of the trust no longer treated as owned by a grantor or other person, continues to report under the tax identification number assigned to the trust prior to the death of that person. See § 1.671–4(a) of this chapter regarding rules for filing the Form 1041, *"U.S. Income Tax Return for Estates and Trusts,"* where only a portion of the trust is treated as owned by one or more persons under subpart E.

(ii) *Furnishing correct taxpayer identification number to payors following the death of the decedent.* If the trust continues after the death of the decedent and is required to obtain a new taxpayer identification number under paragraph (a)(3)(i)(A) of this section, the trustee must furnish payors with a new Form W–9, *"Request for Taxpayer Identification Number and Certification,"* or an acceptable substitute Form W–9, containing the new taxpayer identification number required under paragraph (a)(3)(i)(A) of this section, the name of the trust, and the address of the trustee.

(4) *Taxpayer identification number to be used by a trust upon termination of a section 645 election*—(i) *If there is an executor.* Upon the termination of the section 645 election period, if there is an executor, the trustee of the former electing trust may need to obtain a taxpayer identification number. If § 1.645–1(g) of this chapter regarding the appointment of an executor after a section 645 election is made applies to the electing trust, the electing trust must obtain a new TIN upon termination of the election period. See the instructions to the Form 1041 for whether a new taxpayer identification number is required for other former electing trusts.

(ii) *If there is no executor.* Upon termination of the section 645 election period, if there is no executor, the trustee of the former electing trust must obtain a new taxpayer identification number.

(iii) *Requirement to provide taxpayer identification number to payors.* If the trustee is required to obtain a new taxpayer identification number for a former electing trust pursuant to this paragraph (a)(4), or pursuant to the instructions to the Form 1041, the trustee must furnish all payors of the trust with a completed Form W–9 or acceptable substitute Form W–9 signed under penalties of perjury by the trustee providing each payor with the name of the trust, the new taxpayer identification number, and the address of the trustee.

(5) *Persons treated as payors.* For purposes of paragraphs (a)(2), (3), and (4) of this section, a *payor* is a person described in § 1.671–4(b)(4) of this chapter.

(6) *Effective date.* Paragraphs (a)(3), (4), and (5) of this section apply to trusts of decedents dying on or after December 24, 2002.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 11. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12. In § 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.645–1	1545–1578
* * * * *	

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

Approved December 12, 2002.

Pamela T. Olson,
Assistant Secretary of Treasury.

(Filed by the Office of the Federal Register on December 23, 2002. 8:45 a.m., and published in the issue of the Federal Register for December 24, 2002, 67 F.R. 78371)

Section 6038.—Information Reporting With Respect to Certain Foreign Corporations and Partnerships

T.D. 9033

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Section 6038—Returns Required With Respect to Controlled Foreign Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulation.

SUMMARY: This document contains final and temporary regulations relating to controlled foreign partnerships. This document requires that the United States partner must follow the filing requirements that are specified in the instructions for Form 8865. The text of the temporary regulation also serves as the text of the proposed regulation (REG–124069–02) on page 488 of this Bulletin.

DATES: *Effective Date:* These regulations are effective December 23, 2003.

Applicability Date: For dates of applicability, see §§ 1.6038–3(l) and 1.6038–3T(l).

FOR FURTHER INFORMATION CONTACT: Tasheaya Warren, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1617. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published elsewhere in this issue of the Bulletin.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

In 1997, Congress amended section 6038 to require information reporting by certain United States persons with direct and indirect interests in controlled foreign partnerships (CFPs). Treas. Reg. § 1.6038–3 was published in 1999 (T.D. 8850, 2000–1 C.B. 265 [64 FR 72545] (1999)) (the "1999 Final Regulations") and provides guidance regarding the reporting requirements under section 6038 with respect to CFPs. A United States person required to report under section 6038 with respect to a CFP must file Form 8865, *Return of U.S. Persons With Respect To Certain Foreign Partnerships*. In addition to the reporting obligation imposed on certain partners in foreign partnerships under section 6038, section 6031 requires certain foreign partnerships to file Form 1065, *U.S. Return of Partnership Income* or Form 1065–B, *U.S. Return for Electing Large Partnerships*.

Treas. Reg. § 1.6038–3(j)(1) provides that if a foreign partnership completes and files Form 1065 and a United States partner is required to file Form 8865 with respect to that partnership, the United States partner must attach to its Form 8865 copies of the Form 1065 schedules filed by the partnership instead of completing the Form 8865 schedules that are equivalent to Form 1065 schedules. This rule was added to the 1999 Final Regulations to reduce the burden imposed by those regulations where there is an overlap between section 6038 and section 6031. However, this rule does not directly address the filing requirements for Form 8865, when a United States partner files electronically its income tax return (including any attachments such as Form 8865).

Explanation of Provisions

To facilitate revisions to the filing requirements for Form 8865 (such as electronic filing of Form 8865), the temporary regulation amends Treas. Reg. § 1.6038–3 to provide that a United States partner must follow the filing requirements that are specified in the instructions for Form 8865 when the United States partner must file Form 8865 and the partnership completes and files Form 1065 or Form 1065–B. As a transitional matter, for the next filing season it is anticipated that the instructions for Form 8865 will continue to provide for the existing filing procedure pursuant to which a United States partner attaches certain schedules from Form 1065 or Form 1065–B to its Form 8865 as well as provide for an alternative electronic filing procedure for Form 8865.

The final regulation also makes two revisions to the 1999 Final Regulations. If a U.S. person is required to file Form 8865, Treas. Reg. § 1.6038–3(g)(1) provides that a U.S. person must submit any information that Form 8865 or its accompanying instructions require to be submitted. The final regulation clarifies the requirement under Treas. Reg. § 1.6038–3, as reflected in the Form 8865 instructions, that the United States partner must include the foreign partnership's name, address, and taxpayer identification number on Form 8865. The final regulation also corrects a cross reference in Treas. Reg. § 1.6038–3(b)(9) (*Example 1*).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, this temporary regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of this regulation is Tasheaya Warren, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in its development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6038–3 is amended as follows:

1. The last sentence in paragraph (b)(9) *Example 1* is revised.

2. Paragraphs (g)(1)(i) through (g)(1)(v) are redesignated as paragraphs (g)(1)(ii) through (g)(1)(vi), respectively.

3. New paragraph (g)(1)(i) is added.

4. Paragraphs (j) and (l) are revised.

The revisions and addition read as follows:

§ 1.6038–3 Information returns required of certain United States persons with respect to controlled foreign partnerships (CFPs).

*****

(b) ***

(9) ***

Example 1. Sole U.S. partner does not own more than a fifty-percent interest. * * *

See also § 1.6046A-1(f)(1) regarding the overlap between sections 6038B and 6046A).

*****

(g) *** (1) ***

(i) The name, address, and taxpayer identification number (if any) of the foreign partnership of which the person qualified as a controlling fifty-percent partner or a controlling ten-percent partner;

*****

(j) [Reserved]. For further guidance, see § 1.6038–3T(j).

*****

(l) *Effective date.* Except as otherwise provided, this section shall apply for tax years of a foreign partnership ending on or after December 31, 2000. For tax years of a foreign partnership prior to December 23, 2003, see § 1.6038–3(j) in effect prior to these amendments (see 26 CFR part 1 revised April 1, 2002).

Par. 3. Section 1.6038–3T is added to read as follows:

§ 1.6038–3T Information returns required of certain United States persons with respect to controlled foreign partnership (CFPs) (temporary).

(a) through (i)(2) [Reserved]. For further guidance, see § 1.6038–3(a) through (i)(2).

(j) *Overlap with section 6031.* A partner may be required to file Form 8865 under this section and the foreign partnership in which it is a partner may also be required to file a Form 1065 or Form 1065–B under section 6031(e) for the same partnership tax year. For cases where a United States person is a controlling fifty-percent partner or a controlling ten-percent partner with respect to a foreign partnership, and that foreign partnership completes and files Form 1065 or Form 1065–B, the instructions for Form 8865 will specify the filing requirements that address this overlap in reporting obligations.

(k) [Reserved]. For further guidance, see § 1.6038–3(k).

(l) *Effective date.* This section shall apply to tax years of a foreign partnership ending on or after December 23, 2003. The applicability of this section expires on December 20, 2005.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

*****

(b) ***

CFR part or section where identified and described	Current OMB control No.
*****	
1.6038–37	1545–1617
*****	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 5, 2002.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 20, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 23, 2002, 67 F.R. 78174)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Establishing Defenses to the Imposition of the Accuracy-Related Penalty

REG–126016–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that limit the defenses available to the imposition of the accuracy-related penalty when taxpayers fail to disclose reportable transactions or fail to disclose that they have taken a position on a return based upon a regulation being invalid. By limiting a taxpayer's ability to use an opinion or advice from a tax professional as a basis for a defense, the proposed regulations are intended to promote the disclosure of reportable transactions and positions by taxpayers that conflict with regulations issued by the Secretary. The proposed regulations also clarify the existing regulations with respect to the facts and circumstances that the IRS will consider in determining whether a taxpayer acted with reasonable cause and in good faith in relying on an opinion or advice.

DATES: Written or electrically generated comments and requests for a public hearing must be received by March 31, 2003.

ADDRESSES: Send submissions to CC:IT&A:RU (REG–126016–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:IT&A:RU (REG–126016–01), Courier's Desk, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at: *www.irs.gov/regs.*

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jamie G. Bernstein or Heather L. Dostaler at (202) 622–4940; concerning submissions of comments and requests for a public hearing, Ms. LaNita Van Dyke of the Regulations Unit at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations amending the regulations promulgated pursuant to sections 6662 and 6664, relating to the accuracy-related penalty. Section 6662 provides for the imposition of an accuracy-related penalty for underpayments of tax, including underpayments due to negligence or disregard of rules or regulations and understatements that are *substantial* within the meaning of the statute. Taxpayers, however, can avoid the accuracy-related penalty if they can establish, among other things, that there was reasonable cause for the underpayment and that they acted in good faith within the meaning of section 6664(c).

Temporary regulations issued under section 6011 require taxpayers to disclose *reportable transactions* on their returns within the meaning of those temporary regulations. Treas. Reg. § 1.6011–4T. Reportable transactions may be abusive tax avoidance transactions. The early identification of potentially abusive tax avoidance transactions is a high priority for the IRS and Treasury. On October 22, 2002, the IRS and Treasury published proposed and temporary regulations that significantly revise the definition of certain types of reportable transactions. See Tax Shelter Disclosure Statements, (T.D. 9017, 2002–45 I.R.B. 815 [67 FR 64799] and REG–103735–00, 2002–45 I.R.B. 832 [67 FR 64840]) (October 22, 2002) (to be codified in 26 CFR parts 1, 20, 25, 31, 53, 54, 56, and 301). The proposed amendments to the disclosure rules under section 6011 generally will apply to transactions entered into on or after January 1, 2003.

The IRS and Treasury believe that taxpayers have improperly relied on opinions or advice issued by tax advisors to establish reasonable cause and good faith as a basis for avoiding the accuracy-related penalty, even when the opinion or advice relates to a reportable transaction that the taxpayer should have, but did not, disclose pursuant to § 1.6011–4T. The IRS and Treasury also believe that taxpayers have improperly relied upon opinions or advice that a regulation is invalid without disclosing on their returns their position that the regulation is invalid.

Accordingly, the IRS and Treasury have concluded that the regulations under sections 6662 and 6664 should be amended and clarified so that (1) a taxpayer who takes a position that a regulation is invalid cannot rely on an opinion or advice to satisfy the reasonable cause and good faith exception under section 6664(c) with respect to any underpayment attributable to such position if the position was not disclosed on a return; and (2) a taxpayer who engages in a reportable transaction cannot rely on an opinion or advice to satisfy the reasonable cause and good faith exception under section 6664(c) with respect to any underpayment attributable to the transaction if the transaction was not disclosed pursuant to the regulations promulgated under section 6011. Further, a taxpayer who engages in a reportable transaction cannot rely on the realistic possibility standard under section 6662 to avoid the accuracy-related penalty for negligence or disregard of rules or regulations if the position regarding the reportable transaction is contrary to a revenue ruling or notice.

Explanation of Provisions

These proposed regulations amend 26 CFR part 1 relating to the defenses available to the imposition of the accuracy-related penalty under section 6662(b)(1) (underpayments of tax attributable to negligence or disregard of rules or regulations) and the general exception to the accuracy-related penalty under section 6664(c).

Under these proposed regulations, the adequate disclosure exception to the accuracy-related penalty for underpayments of tax attributable to negligence or disregard of rules or regulations (see § 1.6662–3(a)) will not apply to underpayments relating to a reportable transaction unless the reportable transaction also is disclosed under § 1.6011–4T. In addition, if a position relates to a reportable transaction and is contrary to a revenue ruling or notice (other than a notice of proposed rulemaking), a taxpayer may not rely upon the fact that the posi-

tion has a realistic possibility of being sustained on the merits as a defense to the penalty imposed under section 6662(b)(1). The taxpayer instead would be required to satisfy the adequate disclosure exception under § 1.6662–3(c)(1), including the disclosure of the reportable transaction under § 1.6011–4T.

The proposed regulations also clarify and modify the standards for, and limits on, the use of opinions and advice to satisfy the reasonable cause and good faith exception under section 6664(c) as a defense to the imposition of the accuracy-related penalty under section 6662. The proposed regulations, for instance, clarify that a taxpayer's education, sophistication and business experience will be relevant in determining whether the taxpayer's reliance on the opinion or advice was reasonable and made in good faith. The IRS currently takes these facts and circumstances into account in determining whether a taxpayer has satisfied the reasonable cause and good faith exception under section 6664(c).

These proposed regulations amend § 1.6664–4(c) to specify when a taxpayer cannot rely upon an opinion or advice to satisfy the reasonable cause and good faith exception. Taxpayers who do not disclose positions based upon a regulation being invalid (see § 1.6662–3(c)(2)) cannot use an opinion or advice concerning the invalidity of the regulation as a basis for satisfying the reasonable cause and good faith exception under section 6664(c). Similarly, the proposed regulations prohibit taxpayers from using an opinion or advice as a basis for satisfying the reasonable cause and good faith exception under section 6664(c) with respect to a reportable transaction that the taxpayer did not disclose in accordance with § 1.6011–4T.

Under these proposed regulations, a taxpayer, in order to properly disclose a transaction, may be required to file with the taxpayer's return more than one disclosure form for the same transaction in order to satisfy the requirements in the regulations under sections 6662 and 6664 (as modified by these proposed regulations), and section 6011. The IRS and Treasury may consider permitting taxpayers to use a single disclosure document to satisfy those regulations, provided that all required information is provided by the taxpayer and provided that the taxpayer files a copy of the document with the Office of Tax Shelter Analysis as required under § 1.6011–4T (or as may be otherwise provided in any successor regulations).

Proposed Effective Date

These regulations are proposed to apply to returns filed after December 30, 2002, with respect to transactions entered into on or after January 1, 2003, to coincide with the temporary regulations relating to disclosure, promulgated under section 6011 and applicable for transactions entered into on or after January 1, 2003. The IRS, however, cautions taxpayers and tax practitioners that it will rigorously apply the existing facts and circumstances standard under § 1.6664–4(c) regarding a taxpayer's reasonable reliance in good faith on advice from a tax professional, as well as the other provisions of the regulations under sections 6662 and 6664, including § 1.6664–4(c) relating to special rules for the substantial understatement penalty attributable to tax shelter items of a corporation. In addition to the modifications contained in these proposed regulations, and regardless of when a transaction was entered into, the IRS, in appropriate circumstances, may consider a taxpayer's failure to disclose a reportable transaction or failure to disclose a position that a regulation is invalid as a factor in determining whether the taxpayer has satisfied the reasonable cause and good faith exception under section 6664(c) to the accuracy-related penalty.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Jamie G. Bernstein and Heather L. Dostaler of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6662–3 is amended by:

1. Revising paragraph (a).

2. Revising the last sentence of paragraph (b)(2).

3. Revising the first sentence of paragraph (c)(1).

The revisions read as follows:

§ 1.6662–3 Negligence or disregard of rules or regulations.

(a) *In general.* If any portion of an underpayment, as defined in section 6664(a) and § 1.6664–2, of any income tax imposed under subtitle A of the Internal Revenue Code that is required to be shown on a return is attributable to negligence or disregard of rules or regulations, there is added to the tax an amount equal to 20 percent of such portion. The penalty for disre-

garding rules or regulations does not apply, however, if the requirements of paragraph (c)(1) of this section are satisfied and the position in question is adequately disclosed as provided in paragraph (c)(2) of this section (and, if the position relates to a reportable transaction as defined in § 1.6011–4T(b), the transaction is disclosed in accordance with § 1.6011–4T), or to the extent that the reasonable cause and good faith exception to this penalty set forth in § 1.6664–4 applies. In addition, if a position with respect to an item (other than with respect to a reportable transaction, as defined in § 1.6011–4T(b)) is contrary to a revenue ruling or notice (other than a notice of proposed rulemaking) issued by the Internal Revenue Service and published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), this penalty does not apply if the position has a realistic possibility of being sustained on its merits. See § 1.6694–2(b) of the income tax return preparer penalty regulations for a description of the realistic possibility standard.

(b) * * *

(2) * * * Nevertheless, a taxpayer who takes a position (other than with respect to a reportable transaction, as defined in § 1.6011–4T(b)) contrary to a revenue ruling or a notice has not disregarded the ruling or notice if the contrary position has a realistic possibility of being sustained on its merits.

* * * * *

(c) * * * (1) * * * No penalty under section 6662(b)(1) may be imposed on any portion of an underpayment that is attributable to a position contrary to a rule or regulation if the position is disclosed in accordance with the rules of paragraph (c)(2) of this section (and, if the position relates to a reportable transaction as defined in § 1.6011–4T(b), the transaction is disclosed in accordance with § 1.6011–4T) and, in case of a position contrary to a regulation, the position represents a good faith challenge to the validity of the regulation.

Par. 3. Section 1.6664–0 is amended by:

1. Adding an entry for § 1.6664–4(c)(1)(iii).

2. Redesignating the entries for § 1.6664–4(c)(2) and (c)(3) as § 1.6664–4(c)(3) and (c)(4), respectively.

3. Adding a new entry for § 1.6664–4(c)(2).

The additions read as follows:

§ 1.6664–0 Table of contents.

* * * * *

§ 1.6664–4 Reasonable cause and good faith exception to section 6662 penalties.

* * * * *

(c) * * *

(1) * * *

(iii) Reliance on the invalidity of a regulation.

(2) Opinions or advice relating to reportable transactions.

* * * * *

Par. 4. Section 1.6664–4 is amended by:

1. Revising paragraph (c)(1) introductory text.

2. Revising the last sentence of paragraph (c)(1)(i).

3. Adding paragraph (c)(1)(iii).

4. Redesignating paragraphs (c)(2) and (c)(3) as paragraphs (c)(3) and (c)(4), respectively.

5. Adding a new paragraph (c)(2).

The revision and additions read as follows:

§ 1.6664–4 Reasonable cause and good faith exception to section 6662 penalties.

(c) *Reliance on opinion or advice* — (1) *Facts and circumstances; minimum requirements.* All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law. For example, the taxpayer's education, sophistication and business experience will be relevant in determining whether the taxpayer's reliance on the advice was reasonable and made in good faith. In no event will a taxpayer be considered to have reasonably relied in good faith on advice (including an opinion) unless the requirements of this paragraph (c)(1) are satisfied and the advice is not disqualified under paragraph (c)(2) of this section. The fact that these requirements are satisfied, however, will not necessarily establish that the taxpayer reasonably relied on the advice (including the opinion of a professional tax advisor) in good faith. For example, reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

(i) * * * In addition, the requirements of this paragraph (c)(1) are not satisfied if the taxpayer fails to disclose a fact that it knows, or reasonably should know, to be relevant to the proper tax treatment of an item.

* * * * *

(iii) *Reliance on the invalidity of a regulation.* A taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the taxpayer adequately disclosed, in accordance with § 1.6662–3(c)(2), including the disclosure of the position that the regulation in question is invalid, and, if the position relates to a reportable transaction as defined in § 1.6011–4T(b), the transaction is disclosed in accordance with § 1.6011–4T.

(2) *Opinions or advice relating to reportable transactions.* Taxpayers may not reasonably rely on an opinion or advice of a tax advisor if the opinion or advice is disqualified under this paragraph. An opinion or advice is disqualified if it relates to the appropriate tax treatment of a reportable transaction, as defined in § 1.6011–4T(b), and the taxpayer does not disclose the transaction in accordance with § 1.6011–4T.

* * * * *

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 30, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 31, 2002, 67 F.R. 79894)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulation and Notice of Public Hearing

Section 6038—Returns Required With Respect to Controlled Foreign Partnerships

REG–124069–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulation and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing a temporary regulation (T.D. 9033) relating to controlled foreign partnerships. That document requires that the United States partner must follow the filing requirements that are specified in the instructions for Form 8865. The text of that regulation also serves as the text of this proposed regulation. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by March 24, 2003. Outlines of topics to be discussed at the public hearing scheduled for March 12, 2003, at 10 a.m., must be received by February 19, 2003.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–124069–02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–124069–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS internet site at *www.irs.gov/regs.* The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Tasheaya Warren, (202) 622–3860; concerning submissions and the hearing, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by February 21, 2003. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this regulation is in § 1.6038–3T. This information is required by the IRS to identify foreign partnerships which are controlled by United States persons and verify amounts reported by the partners. The collection of information is mandatory. The likely respondents will be individuals and business or other for-profit organizations.

The burden of complying with the collection of information required to be reported on Form 8865 is reflected in the burden for Form 8865. The estimated number of respondents is 5000. The estimated burden for the 2001 Form 8865 per respondent is 89 hours.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

The temporary regulation in this issue of the Bulletin amends 26 CFR part 1. If a foreign partnership files Form 1065 or Form 1065–B and a United States partner is required to file Form 8865 with respect to that partnership, the temporary regulation amends Treas. Reg. § 1.6038–3 to provide that the United States partner must follow the filing requirements that are specified in the instructions for Form 8865. The text of the temporary regulation also serves as the text of this proposed regulation. The preamble to the temporary regulation explains the temporary regulation and this proposed regulation.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and because this regulation does not impose a collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before this proposed regulation is adopted as a final regulation, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 12, 2003, at 10 a.m., in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the immediate en-

trance area more than 30 minutes before the hearing starts. For information about having your name on the building access list to attend the hearing, see the For Further Information Contact portion of this preamble. The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by February 19, 2003. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this regulation is Tasheaya Warren, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6038–3 is amended by revising paragraph (j) to read as follows:

§ 1.6038–3 Information returns required of certain United States persons with respect to controlled foreign partnerships (CFPs).

*****

(j) [The text of the proposed amendment to § 1.6038–3(j) is the same as the text for § 1.6038–3T(j) published elsewhere in this issue of the **Federal Register**.]

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 20, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 23, 2002, 67 F.R. 78202)

Redemptions Taxable as Dividends; Correction

Announcement 2003–9

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to a notice of proposed rulemaking and notice of public hearing (REG–150313–01, 2002–44 I.R.B. 777) which was published in the **Federal Register** on Friday, October 18, 2002 (67 FR 64331). This regulation provides guidance regarding the treatment of the basis of redeemed stock when a distribution in redemption of such stock is treated as a dividend, as well as guidance regarding certain acquisitions of stock by related corporations that are treated as distributions in redemption of stock.

FOR FURTHER INFORMATION CONTACT: Lisa K. Leong at (202) 622–7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The proposed regulations that are the subject of these corrections are under sections 302, 304, 704, 861, 1371, 1374, and 1502 of the Internal Revenue Code.

Need for Correction

As published, this notice of proposed rulemaking contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking and notice of public hearing (REG–150303–01, 2002–44 I.R.B. 777), which is the subject of FR. Doc. 02–26449, is corrected as follows:

1. On page 64332, column 1, in the preamble under the paragraph heading "Paperwork Reduction Act", paragraph 7, line 12, the language "loss. The respondents are shareholders", is corrected to read "loss (or gain, as appropriate). The respondents are shareholders".

§ 1.302–5 [Corrected]

2. On page 64339, column 1, § 1.302–5, paragraph (d)(8), line 4 from the bottom of the paragraph "accelerated inclusion date shall be made" is corrected to read "accelerated loss inclusion date shall be made".

3. On page 64340, column 3, § 1.302–5, paragraph (f)(9), of *Example 7*, lines 6 and 7, the language "equal to PS's basis in the corporation Z stock, ($50 after application of section 301(c)(2)), is", is corrected to read "(equal to PS's basis in the corporation Z stock, ($50 after application of section 301(c)(2)) is".

§ 1.304–3 [Corrected]

4. On page 64342, column 3, § 1.304–3, paragraph (a), lines 21 through 24, the language "For the treatment of the redeemed shareholder's basis in the redeemed stock in such cases, see § 1.302–5." is removed.

Cynthia E. Grigsby,
Chief, Regulations Unit, Associate Chief Counsel (Income Tax and Accounting).

(Filed by the Office of the Federal Register on December 24, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 26, 2002, 67 F.R. 78761)

Foundations Status of Certain Organizations

Announcement 2003–10

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foun-

dations described in section 509(a) of the Code) are now classified as private foundations:

1st Class, Ridgefield, WA
360 Whitehall Housing Development Fund Corporation, Albany, NY
Abundant Living Self-Investment Associates Ministries, Inc., Little Rock, AR
Access Laporte County, Michigan City, IN
Access to Loans for Learning Finance Corporation, Los Angeles, CA
Access to Loans for Learning Student Credit Corporation, Los Angeles, CA
Acrosports Advocate, Detroit, MI
Actions Community Development Corporation, Houston, TX
Acts Ministries, Stansbury Park, UT
ADR Education Foundation, Inc., Philadelphia, PA
African-American Advocacy Education and Training Consultant Group, Incorporated, Syracuse, NY
African Immigrant Mission USA, Inc., West Orange, NJ
African Universities Foundation, Inc., Olney, MD
AHEC Foundation of Southwest Oregon, Roseburg, OR
Al-Bright Children Educational Foundation Trust, San Rafael, CA
All Helping Hands, Inc., Lake City, FL
Allen Temple Neighborhood Development Corporation, Inc., Riviera Beach, FL
American Friends of the Vienna State Opera, Beverly Hills, CA
Anchor Bay Square Club, New Baltimore, MI
Antietam Skating Club, Frederick, MD
Artists With Disabilities, Inc., Mahopac, NY
Association for Bible Study, New York, NY
Astrological Institute, Scottsdale, AZ
Bayanihan Cultural Organization, Hayward, CA
Berthoud Baseball Association, Berthoud, CO
Black Hispanics Educational Foundation, Bronx, NY
Bring Me a Book Foundation, Mountain View, CA
Buffalo Women's Amateur Soccer Association, Ltd., Williamsville, NY
Buttons & Bows Family Child Development Center, Incorporated, Inkster, MI
Canon McMillan Baseball Association, Canonsburg, PA
Career Access California, Inc., Burlingame, CA
Carolina Family Alliance, Spartanburg, SC
Center for Advanced Transportation Technologies, Monroeville, PA
Center for Scientific Visualization, Ltd., New York, NY
Center for Social Ministry, Berkeley, CA
Charanjit Singh Batth Foundation, Caruthers, CA
Chennai Educational Foundation, Inc., Vienna, VA
Cherrie Williams Foundation, Gardena, CA
Childcare International, Inc., Miami, FL
Children of Peace, Inc., Buffalo, NY
Christian Business & Consumer Ministries Corporation, Fairhope, AL
Christian Family, Greeley, CO
Circuit Foundation, Brooklyn, NY
Citizens for Buckeye Basin Parks, Inc., Toledo, OH
Commanchees Retreat Organization, Galion, OH
Communities With Vision, Inc., Sorrento, FL
Community Development Corporation of LaFourche, Raceland, LA
Community Resources Technology, Inc., Lexington, MA
Community Revival Corporation, Spring Valley, NY
Communitys Jennie Dean Project, Manassas, VA
Comprehensive Human Resources, Inc., Newton, MA
Connecticut Spirit Association, Woodbridge, CT
Copernicus Foundation, Inc., Boston, MA
Council International Study Programs, Inc., New York, NY
Council on Holistic Healing and Recovery, Houston, TX
Covenant Academy, Inc., Asheboro, NC
Crusaders Community Development Corporation, Philadelphia, PA
David Merrick and Natalie Lloyd Foundation, Inc., New York, NY
Deep Waters Ministry, Inc., Port Washington, NY
Deliverance Outreach Center, New Haven, CT
D.E.R.E.K. Program, Minneapolis, MN
District 39 Educational Foundation, Wilmette, IL
Duplin County Agri-Community Center Foundation, Kenansville, NC
Each One Help One Teach One, Los Angeles, CA
Eagle Vision Society, Oklahoma City, OK
Easley & Associates Christian Development, Inc., West Palm Beach, FL
Eastbridge, Norwalk, CT
Educational Video Foundation, Silverton, OR
Enable, Inc., Everett, PA
Endangered Liberties Research Institute, Washington, DC
ESPA, Warrensville Hts., OH
Eufaula-Barbour County Historic Foundation, Eufaula, AL
F. D. Thomas Educational & Enrichment Center, Inc., Thomasville, NC
Fire Island Wilderness Committee, Inc., Brookhaven, NY
Fire Wind & Rain Ministries, Council Bluffs, IA
Flame of Fire, Eastman, GA
Foundation for Environmental Education Development, Reno, NV
Freedom Institute, Springfield, MO
FreshStart, Inc., Memphis, TN
Friendly Village Mobilehome Park Corporation, Santa Ana, CA
Friends in Friendship, Greensboro, NC
Friends It Is, Sylmar, CA
Full Harvest, Florissant, MO
Fundacion Oftalmologica De La Pena, Montebello, CA
Fundamental Resources, Inc., Detroit, MI
Garden Square North Development Company, Pittsburgh, PA
Get High on Life/Be D.E.A.R. to Yourself, Inc., Huntington Beach, CA
Gethsemane Garden Day Care Center, Memphis, TN
Global Health Access Foundation, Tiburon, CA
Global Software Institute, Leverett, MA
Go Ye Ministries, Inc., Alturas, FL
Golden Bridge of Friendship Organization, Inc., Suffern, NY
Grady County Children & Youth Coordinating Council, Inc., Cairo, GA
Graham-Kapowsin Community Council, Spanaway, WA
Green Mountain Wildlife Network, Middlesex, VT
Haitian American Civic Center, Inc., Brooklyn, NY
Hallmark Opportunities for Progressive Education HOPE, Sebastapol, CA
Hand In Hand We Can, Oakley, CA
Hannah Project, Incorporated, Ocala, FL
Health Beat, Inc., White Plains, NY
Help One Another Club, Inc., Mequon, WI

Hispanic Franchise Foundation, Inc., Los Angeles, CA
Holy Awakening Movement Global Love Church, Burbank, CA
Homestead Hill, Inc., North Adams, MA
Hopeville Institution, San Antonio, TX
Improving Education, Inc., Stamford, CT
In-Touch Community Development, Inc., Fort Lauderdale, FL
Indiana Federation of Families for Childrens Mental Health, Indianapolis, IN
Indus Foundation, Sudbury, MA
Innovation Research, San Leandro, CA
Innovative Educational Design, Pullman, WA
Institute for Sisters of Respect, Clearwater, FL
Institute for the Restoration of Antiquities, Inc., Teaneck, NJ
Institutional Scholarship Foundation, Pittsburgh, PA
Inter-Americas Research and Information Center, Inc., Medford, OR
Interlight Productions, Inc., Studio City, CA
International Botanical Conservatory & Gardens of New Jersey, Fair Lawn, NJ
International Institute for Head and Neck Cancer and Tobacco Related Diseases, Inc., New York, NY
Janshee Educational Services, Inc., Miami, FL
Jesus Way, Staten Island, NY
John A. Reisenbach Foundation, New York, NY
Joshua Foundation, Inc., Nashville, TN
Just Kids of Sarasota, Inc., Sarasota, FL
Kamaaina United to Protect the Aina, Honaunau, HI
Keep Lowndes-Valdosta Beautiful, Inc., Valdosta, GA
Kids X-Pressions, Inc., Cumming, GA
Kings Mission, Engelhard, NC
Knowledge Initiative, Inc., Cabin John, MD
Koftbrol, Inc., Bronx, NY
KVMHC Housing, Inc., Waterville, ME
Labor Council for Latin American Advancement-Rock, Janesville, WI
Lafayette Elderly Housing Development Corporation II, Carencro, LA
LaFourche Schools Education Foundation, Inc., Thibodaux, LA
Lake Economic Development, Inc., Belle Glade, FL
Largess, South Euclid, OH
Landmark Development Enterprises, New Orleans, LA
Lee House, Inc., Valley Falls, KS
Libyan American Friendship Association, Merrifield, VA
LIFE Institute, Inc., Louisville, KY
Lifequest Foundation, Saugus, CA
Lift Corporation, Indianapolis, IN
Light of Hope Community Development Corporation, Chester Township, PA
Light of Hope Seniors Residence Development, Corp., Chester Township, PA
Livingston County Community Foundation, Chillicothe, MO
Los Angeles County Bomberos, Incorporated, Montebello, CA
Louisiana Technical College-Tallulah Foundation, Tallulah, LA
M&S Kolel Grocery, Inc., Spring Valley, NY
Maes Family Day Care, Hawthorne, CA
Marin County Chaplains Assoc., San Rafael, CA
Marvellous Light Corporation, El Paso, TX
Mazzei Foundation, Inc., Tulsa, OK
Meals 4 U, Grosse Pointe Woods, MI
Mecuda Foundation, Ltd., College Park, MD
Mega Booster Club, Evansville, IN
Metro Health California, Inc., Roswell, GA
Mid America Arts Foundation, Kansas City, KS
Miracle Drummer and Dancers, Inc., Wasilla, AK
Miriam House Children's Residential Care Facility, Houston, TX
MIRTH, Inc., Pasadena, CA
Mission Arlington, Inc., Arlington, TX
Mission Connect, Houston, TX
Monroe Meadows, Inc., Monroe, MI
Mound Bayou Community Development Corporation, Incorporated, Mound Bayou, MS
Mr. & Mrs. Everett E. Brockett Scholarship Fund, Inc., Southampton, NY
Nanocomputer Dream Team, Inc., San Antonio, TX
National Cancer Research & Education Foundation, Blacksburg, VA
National Manufactured Home Owners Institute, Willow Street, PA
National Training and Information Center, Sacramento, CA
NCAL-Winston-Salem, Winston-Salem, NC
Neighbors Helping Neighbors, Canton, OH
Nevada Bar Foundation, Las Vegas, NV
New Directions Treatment Center, Danville, IL
New Start Counseling Services, Peoria, AZ
New World Impact Education, Corville, AZ
Nick B. Della Foundation, Inc., Visalia, CA
Ninth Street Mobilehome Park Corporation, Santa Ana, CA
Now Choose Life Ministries, Suprise, AZ
NPF Enterprises, Las Vegas, NV
Oceanography Research & Development, Southwick, MA
Old Town Princeton Foundation, Inc., Bluefield, WV
Open Your Heart Fund, Inc., Flushing, NY
Orangewood Mobilehome Park Corporation, Santa Ana, CA
Pacific Palms Mobilehome Park Corporation, Santa Ana, CA
Pasadena Museum of Art, Pasadena, CA
Personal Technology Institute, Inc., Rochester, NY
Pet Emergency & Disaster Assistance, Inc., Lakewood, CA
Prairie View A&M University Class of 1949 50th Year Endowed Scholarship Fund, Inc., Prairie View, TX
Praise Him Ministries, North Easton, MA
Prayer and Miracles, Inc., Detroit, MI
Prep First American Resources & Services Corporation, Tucson, AZ
Pro-Visions for Life, Yuma, AZ
Progressive Lakeside Golfers Associations, Inc., Shreveport, LA
Project Reach, Inc., Houston, TX
Pug Rescue of Southeast Texas, Sugar Land, TX
Quachita Regional Soccer Association, Monroe, LA
Ricky Edwards Ministries, Pawnee, OK
Royal Knights Jr. Athletic Association, St. Louis, MO
Rural Community Development Corporation, Port Gibson, MS
Russkaya Artists Group, Athens, OH
Safeguarding America for Everyone (S.A.F.E.) Foundation, Inc., Upper Marlboro, MD
Saint Paul Community Development Corporation, Lake Helen, FL
Salmon Recovery Forum, Inc., Bend, OR
San Fernando Valley Philharmonic Pops Orchestra, Inc., Woodland Hills, CA
San Jose Community Center, San Jose, NM
Save-A-Stray, Inc., Troutman, NC
Second Chance Community Development, Inc., Lauderhill, FL
Second Chance Outreach Ministries, Inc., Memphis, TN
Sickle Cell Disease International Foundation, Inc., Boston, MA
Silent Teens Organization, Canoga Park, CA

Sisterhood on the Move, Mattapan, MA
Spirit Acres Daycamp Foundation, Riverton, CA
Spring Valley Terrace, Inc., Tempe, AZ
St. Marys Youth Baseball Association, Inc., St. Marys, PA
Star of Christopher, Inc., Coon Rapids, MN
Stone Institute for Challenged Adolescents, Austin, TX
Stonehenge Foundation, Incorporated, Gladwyne, PA
Stratford Housing Development Fund Corporation, New York, NY
Studio in the Hood, Inc., Carbondale, IL
Summerdale Court, Inc., Pittsburgh, PA
Teensafe, Inc., Hurley, NM
Temple Foundation, Inc., White Plains, NY
Temple of Knowledge, St. Louis, MO
Tennessee Breakers Basketball Club, Oak Ridge, TN
Teresa Anne Eglet Galvin Scholarship Fund, Inc., Basking Ridge, NJ
Tippecanoe County Cooperative Extension Board, Lafayette, IN
Treatment Resources, Inc., Richmond, VA
Trinity Educational Center, Inc., Covington, GA
Tropicana Mobilehome Park Corporation, Santa Ana, CA
Troy Housing Development Corporation, Troy, NC
Tupelo Affordable Housing System, Tupelo, MS
Union County Educational Foundation, Inc., Morganfield, KY
Village Developers, Inc., Vineland, NJ
Viridian, Bremerton, WA
Walltown Community Association, Inc., Durham, NC
We are the Clay, Sacramento, CA
Westend Development Corporation, Oakland, CA
What's Up Club, Houston, TX
Wheeling Housing Authority Resident Council, Incorporated, Wheeling, WV
Willow Career Institute, Inc., New York, NY
Wings of Care Association, Auburn, WA
Wish Come True Foundation, Inc., Westerly, RI
Women in Action, Inc., Southfield, MI
Work Opportunity Resource Center, Hawthorne, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as"rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2002–26 through 2002–52 is in Internal Revenue Bulletin 2003–1, dated January 6, 2003.